TRUSTS, POOLS AND CORPORATIONS

EDITED

WITH AN INTRODUCTION

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PREFACE

This volume is intended to be more than a mere collection of economic reprints. Such compilations have often been made; as for example in Dunbar's "Laws relating to Currency, Finance and Banking"; Rand's "Economic History"; and in the Reports of the United States Industrial Commission. This collection is planned for use specifically as a text-book; not merely as a handy volume for reference, or as a collection of original documents. It is not intended, however, to supplant, but rather to supplement, the standard treatises on the trust problem; and may readily be used in connection with Jenks's "Trust Problem," Ely's "Monopolies and Trusts," or Meade's "Trust Finance." It denotes a deliberate attempt at the application to the teaching of economics of the *case system*, so long successful in our law schools. With this end in view, each chapter is intended to illustrate a single, definite, typical phase of the general subject. The primary motive is to further the interests of sound economic teaching, with especial reference to the study of concrete problems of great public and private interest. A difficulty in the substitution of present-day social and economic studies for the good, old-fashioned, linguistic ones, or for the modern sciences, — a difficulty especially peculiar to descriptive economics as differentiated from economic theory, — has always been to secure data sufficiently concrete, definite and convenient to form a basis for analysis, discussion and criticism. The lecture system has its advantages in stimulating interest and — it is to be hoped — arousing enthusiasm among students. But lectures alone entirely fail

to do justice to the possibilities inherent in economic science for rigorously training the mind in habits of close and consecutive thought. The law has always enjoyed a peculiar and well-merited prominence among other studies for this reason.

The first requisite, therefore, for the successful conduct of economic instruction in the descriptive field is to provide raw material; which in discussion, supplementary to the general lectures, may be worked over in detail in the class room. Such material, by reason of the great increase in economic periodical literature since 1890, is now rapidly augmenting. Yet with classes, as at Harvard University, often aggregating in such economic courses from one to two hundred men, resort by each student to the files of such periodical literature is out of the question. Public documents are also impossible for reference reading with a class of considerable size. And finally, in my judgment, a generally neglected and amazingly rich find lies embedded in the mass of factual evidence accumulated in the course of legal proceedings in our courts. The mere decisions, as long currently used, are of course well known. But it is not the *legal* pronouncement in the case, infrequently interlarded with brief statements of fact; but the actual testimony adduced — "The Record" of evidence submitted — which has rarely been utilized. Such matter must be painstakingly uncovered, abridged, even digested, and made more conveniently accessible to serve its due end for the teacher. To direct attention to this material by a few concrete illustrations from such sources, reprinted in this volume, is not an unimportant motive in its production.

A second, and by no means inconsiderable, motive in the preparation of this volume has been the hope that it might contribute toward a crystallization of public opinion favoring a reasonable policy of public control over monopolistic and corporate enterprises. The general reader and the legislator, in the mass of loose generalizations upon this topic, can scarcely be expected to follow publications in the technical economic

journals. Such articles, unswayed as they should be by selfish interest and personal prejudice, nevertheless, are the main ones which may safely be relied upon in the formation of a final judgment. By gathering together in convenient form this series of papers and documents, it is confidently hoped that progress toward the solution of one of our most troublesome public questions may be in some slight degree facilitated.

Most cordial acknowledgment is due to the Editorial Boards of the *Political Science Quarterly*, the *Economic Journal*, the *Yale Review* and the *Quarterly Journal of Economics*, and in even greater measure to the authors of the several papers herein reprinted, for permission to make use of their material in this enterprise. In every instance a most hearty acquiescence in the project has been expressed, for the which I cannot be too grateful. Without such assent the meagre original contributions of the editor would have made but a sorry show. Nor can I refrain in this instance from an expression of my peculiar obligation to Professor J. W. Jenks of Cornell University, my former colleague in the work of the United States Industrial Commission, who has been long and deservedly recognized as a pioneer in this field of economic study. To my former teacher, Professor Goodnow of Columbia; to my colleague, Professor Bullock; and to Dr. E. S. Meade of the University of Pennsylvania, I am also more than ordinarily indebted. Hon. E. B. Whitney, former Assistant Attorney-General of the United States, now of the New York bar, has also been of great service in awakening my interest in the legal sources of economic information, to which reference has been made. This volume, as it appears, is largely the work of my professional colleagues and friends. It is earnestly to be desired that my editorial endeavors may serve to direct attention anew to the value and interest of their contributions.

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INTRODUCTION

THE historical development of the so-called Trust Problem in the United States naturally falls into four more or less clearly defined periods. The revival of industry following the long depression of 1873–79 began the modern development of large-scale production. Corporations embodying the principles of limited liability, delegated management and indirect ownership became increasingly prominent after 1880. The first period in our trust history may be said, therefore, to extend from about this time until 1887. It was characterized by a steady increase in the size and number of large-scale industrial units. Various pools and the Standard Oil Trust foreshadowed the future. The decade from 1887 to 1897 forms the second period. It was the time of the trust in the strict legal sense. Standard Oil Trust success since 1882 invited imitation in the two important industries of distilling and sugar refining. The progress of monopoly was such that an outbreak of state anti-trust laws from 1889 to 1893 indicated how fully public interest had turned from the regulation of railroads to that of industrial monopoly. It was assumed, in fact, that the railroad question had been in a large measure settled by the enactment of the Interstate Commerce Act in 1887. As instanced later in this brief review, the entire failure of the trust expedient, however, in furnishing a legal basis for monopoly led to various other devices, notably pooling. And the continuation of industrial depression, during the four years to 1897, rendered constructive development unlikely. The third period from 1897 until the Northern Securities decision in the spring of 1904 was largely influenced by the phenomenal prosperity which began in the former year and culminated in 1902. The formation of combinations in various branches of iron and steel manufacture, followed by the great outbreak of corporate promotion in 1899,

led up to the formation of the United States Steel Corporation in 1901. And the prominence of holding corporations, organized under the laws of New Jersey, seemed to offer a convenient substitute for the old and discredited trust.

The latest period in the development of the problem begins with the year 1904. Speculative scandals hereafter mentioned; the great decline of stock market quotations in 1903; the failure of bright promises made by promoters; a reviving interest in railroad regulation and the tariff; and an increasing demand for publicity, have successively made their appearance. More important concretely than all of these, however, was the influence of the Northern Securities decision in the spring of 1904, which determined the legal instability of the holding corporation. The present seems, then, to be a period of uncertainty in the minds of organizers and directors of large-scale production. Having tasted the advantages of monopoly, they are not content to relapse into a régime of competition. Publicity through the newly organized Bureau of Corporations in the United States Department of Commerce has become possible. Faint suggestions of additional repressive legislation appear in spite of increasing proof that the Common Law, even in the absence of statutory enactment, is sufficient, if manfully invoked, to protect the rights of the individual. It remains now to be seen whether new legal expedients in organization will be sought, in the attempt to settle the great controversy between large-scale industry which seeks the advantages of monopoly, and the individual producer and the public who demand the benefits of competition.

Monopoly has been sought under four distinct forms of organization, which may be briefly considered in turn. These are the pool, the trust, the simple corporation and the finance company or holding corporation.

The *pool* is perhaps the oldest, commonest and, at the same time, most recently popular mode of obviating the evils of competition. Industrial pools, in fact, appear at every stage of our economic development since the Civil War. They are not even eliminated from the situation by gigantic mergers, so long as the latter are not absolutely monopolistic. Thus even the

most powerful present-day combinations, such as the United States Steel Corporation, find it necessary to become parties to pooling arrangements with independent producers. The secrecy of these agreements, owing to a wholesome fear of the law, renders them apparently less widespread and effective than they perhaps are in fact. Such agreements may even be international in their scope, as shown by the recent allotment of the European export trade in steel rails in 1904 between the great German Steel Corporation, known as the Stahlwerkverband, and the English rolling mills. A seemingly undue amount of attention has been devoted to the subject of pools in this volume, because of their persistency and evidently increasing adoption in these various ways.

A type of the earliest form of pool is afforded by the Michigan Salt Association, dating practically from 1868. As described hereinafter in detail,[1] this was an agreement for the purchase of the entire output of all the important producers in a certain field. Similar agreements were certainly operative in the decade 1880–90, as in the manufacture and sale of cotton bagging, wherein was controlled perhaps two-thirds of the output of the country. The most notable pools twenty years ago, however, arousing widespread attention, were in the distilling industry. In 1882 and probably even earlier, until the formation of the trust, a limitation of output and allotment of sales was certainly relied upon to prevent undue competition.[2] The well-known pools in the cordage manufacture dating from 1860 are also cases in point. A far less defensible scheme from a moral point of view, revealing the possible evils inherent in pooling, is revealed by the case of the Addyston Pipe Co. Our record of this combination[3] shows it to have consisted of an agreement among competing producers to fix a monopolistic price by means of fictitious bids, with a division of the field to insure complete local monopoly for each plant. More recently still, and developing a peculiar vigor since the failure of other attempts at monopolization, either by outright purchase or a holding company, are the existing pools in the iron and steel industry. These, as described in Chapter IV,

[1] Chapter I, p. 1. [2] See pp. 22 *et seq.* [3] pp. 86 *et seq.*

are acquiring increased importance in the attempt to secure stability of price in a field peculiarly subject to violent fluctuations between prosperity and depression. When reasonably and fairly administered, having due regard, that is to say, to the welfare and patience of the consuming public, they promise some measure of success; otherwise managed, when rapacious in unduly forcing up prices, such pools have generally resulted in collapse; with greater evils both to the public and their own members than those whose cure was attempted. This is clearly exemplified in our reprinted outline of the history of the Wire Nail Association of 1895–96.[1] A still more complicated arrangement, of special interest as throwing light upon the difficult question of public control in our own anthracite coal field, is afforded by the German Coal Cartell, which at the present time completely dominates the situation in that country.[2]

Patent as are the advantages to producers of pooling contracts, they suffer from two inherent defects. Of these the first is that they are at variance with the underlying principles both of common and statute law, and hence are not enforceable in the courts. No effective guarantee for good faith is afforded other than the creation of deposits, the imposition of fines and other more or less mechanical devices. And a second objection lies in the fact that pools are necessarily but temporary expedients after all, affording no certainty for stability of price or of industrial policy for any extended period. It was undoubtedly an appreciation of these facts which led to the attempts in the late '80's to remodel industrial combinations on the pattern of the Standard Oil Trust of 1882. On the other hand, it may perhaps be affirmed truly that the very indefiniteness and elasticity of such agreements has often rendered them successful at times like the present, when more rigid devices are proving somewhat ineffective in controlling prices in the face of a rising tide of independent production.

A *trust* may be defined as an organization managed by a board of trustees to whom all the capital stock of the constitu-

[1] pp. 46 *et seq.*

[2] Publications American Economic Association, 3d ser., Vol. V, 1904, contains an excellent and elaborate study by Dr. Francis Walker.

ent companies is irrevocably assigned; in other words, the original shareholders accept the trustees' certificates in lieu of former evidences of ownership. The outline of a typical trust hereinafter printed will serve as an illustration.[1] As a legal expedient for obviating competition such a trust is usually discussed as if it were now obsolete, possessing historic interest alone. This is only in part true. As an improvement upon the pool, both as regards stability and effectiveness, certainly it merits the importance ascribed to it during the decade following 1887. The first appearance of this legal expedient dates, of course, from the formation of the Standard Oil Trust in 1882.[2] It derived added prominence through the formation of the Distillers and Cattle Feeders' Trust (Whiskey) and the Sugar Trust, both in 1887. It disappeared with the final judicial condemnation under adverse state and Federal legislation in the years 1891–92. The adverse decision in the case of the North River Sugar Refining Co. and the Standard Oil Co., in Ohio, finally proved the impossibility of this legal basis for effecting combinations.[3] Recourse was necessarily had, therefore, to novel expedients, such as corporate organization under the newly revised laws of New Jersey and other charter-bartering states.

It is an odd coincidence, that organization under a board of trustees issuing certificates representative of ownership of property, although condemned by the courts and obsolete as a resource for the great industrial combinations of the country at large, should still flourish under the laws of Massachusetts. This commonwealth has, in the main, steadfastly resisted pressure for a loose, or even for a liberal, policy in corporate legislation; yet it is notable among the other states to-day as permitting the trust form of organization to flourish as an expedient for consolidation. This is perhaps indirectly an outcome of the consistent policy of the state not to permit the holding of real estate for investment by corporations organized

[1] Consult Chapter II, pp. 22 *et seq.*

[2] Miss Ida M. Tarbell's monumental study of the Standard Oil Co. gives full details concerning both the form and dissolution of this trusteeship.

[3] *Vide* pp. 244 and 265 *infra.*

under its general laws. Moreover, this latter practice would be difficult under the common law rule against perpetuities. For about half a century, therefore, real estate in Boston, if held for permanent investment by a number of people jointly, must have its ownership vested in voluntary associations, managed by trustees. An important ruling of the Massachusetts supreme court in 1899, upholding the validity of such associations, has greatly enhanced their prestige. A recent compilation includes no fewer than sixty real estate trusts in the city of Boston alone, holding upwards of $60,000,000 of property.

The immunity from governmental supervision of voluntary associations under trusteeship especially in the issue of capital stock, under the strict Massachusetts anti-stock-watering laws applicable to corporations, has recently invited an extension of the principles of trusteeship into the fields both of transportation and industry. Thus the Massachusetts Electric Companies, controlling the stock of several hundred miles of street railways throughout the eastern part of the state, is managed through a board of trustees. This board issues certificates representing the equity interest of the original stockholders of the constituent companies included in the combination in the enterprise. This, it will be observed, is quite analogous to the devices originally adopted by the Sugar and Standard Oil Trusts. The Massachusetts Gas Companies, in the industrial field, have likewise, as the virtual successors of the New England Gas & Coke Co., acquired control of illuminating plants in and about Boston.[1] Still another form analogous to these is found in the voting trusts until recently so common among American railways. These forms of control as vested in a board of trustees represent, not ownership of stock, but merely a unified voting power during a specified term of years. As applied in the cases of a number of industrial combinations, such as the American Bicycle Co. since reorganization, and the International Mercantile Marine Co. at its inception, these voting trusts vir-

[1] Professor John H. Gray has recently published a considerable series of articles on the Massachusetts gas situation in the *Quarterly Journal of Economics*. Consult the same author's address in *Publications American Academy Political Science*, 1900, and also *Journal of Political Economy*, 1903, pp. 257–272.

tually perpetuate monopoly. Although their primary object purports to be protection against rude disturbance of continuity in financial policy, their utility for the purposes of combination is quite evident. It thus appears that the principle of trusteeship in industrial management is by no means obsolete; although the statement is perhaps true as applicable to consolidation in the great staple interstate industries of the country.

The failure of the Trust form of combination under adverse legislation and judicial decisions[1] came at a time when the industry of the country was languishing. The period from 1893 to 1897 being one of prolonged and acute industrial depression, the tendency toward consolidation made little headway. Sporadic attempts at pooling in the iron and steel industry were made in 1895 and 1896 as herein described.[2] But the resumption of trade activity after this prolonged depression promptly brought the combination question to the fore. At the same time the revival of confidence among investors following a protracted period of speculative dulness opened new channels of activity for the financial agent. Meade, in his Trust Finance, has ably described the work of the industrial promoter at this time. The phenomenal outburst of industrial consolidation in 1899 made necessary a resort to a new legal expedient, that of the *holding corporation.* Prior to the enactment of the revised General Corporation Act of New Jersey in 1899, the uniform practice both in this country and abroad had been to prohibit by law the holding of the stock of one corporation by another. Vast possibilities were involved in the amendment of this clause in a code of American corporation law. Corporate organization could henceforth be promoted, not to serve the ends of industrial management, but solely in order that financial combinations might indirectly control operating companies through ownership of their capital stock. This practice had already been tested in isolated cases among railroads; as, for instance, in the organization of the Pennsylvania Co in 1870 to hold and control the stocks of subsidiary corporations owned by the Pennsylvania Railroad Co. west of Pittsburg. In 1880 the American Bell Telephone Co. was organized under

[1] Consult pp. 244 *et seq.*

[2] pp. 46 and 78 *supra.*

Massachusetts law practically as a holding company. Four years later the Southern Pacific Co. was chartered by the state of Kentucky to hold the stocks of parts of a great railway system in other and remote states. These were, however, all organized under special laws; while the General Corporation Act of New Jersey of 1899 made it possible to organize a pure finance company under a general statute. No operating duties at all were involved other than to hold the stock, elect officers, receive dividends from constituent companies and turn them over to their own shareholders. At the same time it was necessary merely to maintain a nominal connection with the authorities in the chartering state by renting desk room, displaying a sign and making a meagre and non-committal annual report.

Relatively few companies seem to have taken advantage of the New Jersey legislation at once. Among those which have been tested by extended experience is the United States Rubber Co., dating from 1893. Certain decisions of the United States Supreme Court, notably those touching the sugar combination in 1894,[1] manifested an indisposition on the part of the Federal courts to interfere. The prospect was inviting also in many cases because of the elasticity of the arrangement. It enabled promoters to purchase the stock control of companies in the open market rather than at private sale. Less capital would be tied up in effecting a combination; inasmuch as ownership, not of all, but merely of a bare majority of the capital stock of companies absorbed, was necessary. Legal experts, moreover, hoped the scheme would prove invulnerable. Consequently, for a brief period the holding company suddenly assumed a noteworthy prominence in every branch of American business life. The Federal Steel Co., with a capital of about $100,000,000, later absorbed by the United States Steel Corporation, was chartered by New Jersey in 1898. Ownership by stock control was extended over a considerable range of interlocking properties such as ore bodies, steel works and railways. The following year witnessed the incorporation of the Amalgamated Copper Co., capitalized at $75,000,000, as a holding corporation to acquire and control the stocks of copper-mining companies. The year

[1] *U. S.* v. *E. C. Knight Co.* See pp. 255 and 265 *infra*.

1900 was one of pause in the consolidation movement following the craze for company promotion in the preceding year. The gigantic United States Steel Corporation with stocks and bonds aggregating $1,400,000,000 speedily followed.[1] In the railway field the Northern Securities Co. with $400,000,000 of authorized stock was to acquire and control the northern transcontinental railway corporations.[2] Then came the so-called Whiskey Trust, previously transmuted into the Distilling Co. of America, an actual merger of four constituent corporations, taken over by a pure finance company, the Distillers' Security Corporation, capitalized at $32,000,000. The movement invaded the field of commercial distribution in the Associated Merchants Co., a holding corporation organized this time under the laws of Connecticut, to hold the stocks of retail dry goods establishments and incidentally to transact such business on its own account. The Rock Island Co., with a capital of $115,000,000, again of New Jersey, was in 1902 patterned after the Northern Securities Co. As a holding corporation it has formed the basis of wholesale consolidation of railway lines west and south of Chicago. It was even rumored that a Southern Securities Co. would ultimately take over the control of the great transportation systems south of Mason and Dixon's line. In the field of electric transportation, also, the holding company has become exceedingly popular since 1902–03; as witness the prominent instances of the Metropolitan Securities Co. of New York; the Rhode Island Securities Co., owning street railways throughout that commonwealth; and the Public Service Corporation of New Jersey, aiming at consolidation of electric carriage and lighting in an important field.[3]

Owing to the uncertain legal status of the pure finance company or holding corporation since the Northern Securities decision,[4] the tendency at the present time seems to be in favor of an actual merger of constituent corporations in a single company. This form of organization involves an actual exchange, in some agreed ratio, of the securities of the constituent com-

[1] Meade's Trust Finance, Wilgus's United States Steel Corporation and Moody's Truth about the Trusts are perhaps the best references on this company.

[2] *Vide* pp. 322 *et seq.* [3] *Vide* pp. 146 *infra.* [4] *Vide* pp. 322 *et seq.*

panies for those of the absorbing concern. It is what would seem to have been done in the case of the Distilling Co. of America in 1899, afterward replaced by a holding corporation. An earlier example is that of the Trenton Potteries Co., composed of eight factories which united in 1892. It has been frequently stated that the United States Steel Corporation has been strengthening its position, under possible adverse judicial decisions following the line of the Northern Securities case, by likewise eliminating some of its constituent concerns and acquiring a direct ownership.[1] The practical difference between this form of merger and a holding company appears principally in those cases where the holding company owns not all but only a part of the capital stock of its constituent corporations. Where, as in the case of the United States Steel Corporation or the American Agricultural Chemical Company, the entire ownership of the stock of the constituent companies occurs, the holding company becomes truly a legal fiction. There is no legitimate excuse for its existence. The Distillers' Security Corporation, on the other hand, owns only about ninety per cent of the preferred and common stock of its predecessor, the Distilling Co. of America. In the case of railroad holding companies the general rule seems to be that all, or nearly all, of the stock of the operating companies is controlled. The Northern Securities Co. absorbed all of the Northern Pacific stock, although it held merely a controlling interest in the Great Northern Railroad. The Rock Island Co. owns all of the stock of the C., R. I. & P. Railroad Co., which in turn holds nearly all the stock of the C., R. I. & P. Railway Co., which last is the real operating concern. The additional difficulty in the case of the intervention of a holding company which has not absorbed all the securities of its constituent parts is, of course, the existence of a minority interest. Great and growing importance is thereby placed upon the final determination of the rights of minority holders where the majority is not a merely temporary body, but a definite and permanent corporation.

[1] The "community of interest" basis of consolidation so widely heralded among railways has not been industrially applied, except possibly in the Standard Oil Co. after the dissolution of its Trust in 1892.

Another peculiar feature of modern corporate finance which is seemingly an outgrowth of the holding companies is the ever increasing complexity of corporate organization. This evil, for so it must be denominated, is peculiarly apparent in the case of companies controlling municipal franchises. Wheels within wheels multiply until it becomes practically impossible to fix responsibility either in the courts or by way of public control administratively. The Brooklyn Rapid Transit Co.[1] and the Metropolitan Securities Co., controlling the street railways of New York city, have most complicated relations. One of the best illustrations is, however, afforded in the control of the street railways of the city of Providence. The original concern is the Union Railway Co., a Rhode Island corporation. Its stock was purchased by the United Traction and Electric Co. of New Jersey, which company has since leased it again to another Rhode Island corporation, known as the Rhode Island Company. The stock of this corporation is in turn owned by the Rhode Island Securities Co., which is a New Jersey corporation. All the stock of this organization is finally owned by the United Gas and Improvement Co., which is a Pennsylvania corporation. The infinite possibilities in cases of this kind for obscuring profits or losses and minimizing public accountability are too apparent to need elaboration. And where, as sometimes happens, a small number of minority stockholders in each company exists, the confusion is greatly accentuated.

The trust movement has brought to light a number of peculiar *evils in corporate finance*, or rather it has magnified preëxisting tendencies which have long been apparent in the case of smaller organizations. The principal ones may perhaps be classified as fraudulent promotion and speculative management. It is difficult, however, to draw the line clearly between recklessness and downright dishonesty. A vast increase in irresponsible direction has paved the way to financial practice which, according to the point of view, may be denominated as extravagance or fraud.

Many of the *promotions* described in the evidence before the United States Industrial Commission in 1900 impress the conser-

[1] p. 146 *infra.*

vative financier as extravagant. The returns of both organizers and banking syndicates seem to be excessive. Meade, in his able chapters in Trust Finance, has analyzed many of these in detail, showing a certain justification for large profits because of the risk involved. But later developments have brought to light practices in promotion which are more certainly reprehensible, and which merit the name of theft. Two notable instances are described in the official reports of receivers in the cases of the Asphalt and Shipbuilding Companies, reprinted in this volume.[1] Similar practices have also been proven in the organization of the International Salt Co.; wherein, apparently, a syndicate received upward of $6,000,000 worth of stock out of a total of $18,750,000 issued. The scandal of the padded balance sheet of an important combination is too recent to be overlooked; and, despite the secrecy of its promoters, there appears to be every probability that enormous profits were made in the organization of the Amalgamated Copper Co. The most obvious method of stopping these nefarious practices is undoubtedly to have them condemned by the courts. This has been done in several notable instances of late.[2] It would seem to involve less economic loss to remove the incentive to such reckless promotion at the outset, by regulation of the conditions of flotation, as is done in the excellent German law described herein.[3] The Massachusetts policy of restriction has also undoubtedly worked well.[4]

The *payment of unearned dividends* is another evil which in the past has not been curbed by a series of decisions in our American courts attempting to distinguish clearly between capital and income accounts. Nice questions of policy are involved in the determination of net profits. Meade, in his Trust Finance, again has clearly set forth the unwise policy of many industrial combinations in failing to provide a sufficient surplus reserve before beginning the payment of dividends. Unfortunately, instances of downright deception often merging into fraud, have

[1] pp. 182 and 218 *infra*.

[2] On the liability of promoters for unrevealed profits consult the review of cases by the present writer in the *Journal of Political Economy*, Vol. VIII, 1900, pp. 535 *et seq.*

[3] Chapter XVI, p. 393.

[4] Chapter XV, and also p. 126.

made their appearance in the last few years. The Asphalt Companies clearly exemplify the lack of a conservative policy in accounting; as when, for instance, the Audit Co. of New York changed an apparent surplus of $758,000 to a deficit of $541,000. The United States Realty Co. is another case in point. Dividends were here paid on the basis of profits on uncompleted contracts, recalling the similar policy in the case of the U. S. Shipbuilding Co.[1] Numerous other concerns have since been shown to have followed the same practice, notably the New England Cotton Yarn and the Virginia-Carolina Chemical Co. Perhaps the worst offender was the American Malting Co., in a case so extreme and so clearly fraudulent that the courts have held the directors liable both to creditors and stockholders to the full amount of the unearned dividends declared.[2] It is earnestly to be hoped that a few more judgments of this kind will serve to restrain the directorates of other great corporations.

The evil of *speculative management* falls into several distinct parts. The earliest form which it took was the buying and selling by its own officers of the securities of a corporation for speculative purposes. Of this sort are the events in the history of the Whiskey Trust, and a few scattered instances such as the manipulation of Diamond Match funds in 1896. American corporations, unlike those of England and Germany, fail in too many instances to prohibit dealings in the securities of a company by its own officers. The best of them certainly do so, and the scandals of a decade ago probably emphasized the desirability of preventing this evil. An unlimited power to contract loans without the approval of the directors or stockholders, as in the case of the American Ice Co., is also a constant menace to conservative management. Another phase of this matter concerns the temptation to industrial management with a view to its effect upon the stock market rather than upon the permanent welfare of the company. A classic example is afforded

[1] pp. 190 *et seq.*

[2] The first decision before the New Jersey Court of Errors and Appeals held the directors liable; but before the appeal was heard the state legislature so amended the law as to render the final decision of little value. The case was then taken to the Supreme Court of New York, and a decision for damages amounting to over $1,000,000 was obtained in December, 1904.

by the episode of the American Steel & Wire Co. in 1900. Secrecy is a constant invitation to the insider to take advantage of forthcoming events at the expense of the stockholders. It is undeniable also that such speculative management greatly encourages speculative ownership on the part of stockholders. The old-fashioned investor, secure in his belief in the stability of his company, is replaced by a body of temporary holders who look for the returns upon their investment, more in the chances of buying and selling and manipulation, than to permanent and regular dividends. That this kind of ownership is greatly encouraged by the very low quotations of the stocks of overcapitalized companies cannot be doubted.

The spread of the practice of indirect ownership through the mediation of holding or finance companies has also produced a peculiar set of abuses. These are all dependent in the main upon the preservation of secrecy as to the exact status of the operating concern. Dividends or deficits may be shifted at the will of the directors from one to another company of the hierarchy. Only when disclosure is forced by financial stress or judicial proceedings is the real state of affairs revealed. Our reprint of the Receiver's report of the United States Shipbuilding Co. serves to illustrate this evil.[1] Other instances of the creation of large floating debts by constituent companies, which debts are not apparent in the reports of the parent concern, are familiar in the case of the United States Rubber Co. and the New England Cotton Yarn Co. The failure to disclose may, however, at times operate in the other direction. Stockholders are induced to sell because of failure on the part of the management to make clear the accumulated profits of constituent companies. This would seem to be exemplified in the recent history of the companies which constitute the so-called Tobacco Trust. On the formation of the Consolidated Company in 1901, the majority of the common stocks of the American and Continental Tobacco companies were taken over in exchange for four per cent collateral bonds. The holders of the non-dividend Continental stock parted with their property without any knowledge whatever of the profits which it had been earning. Only after

[1] pp. 182 *et seq.*

they had been given in exchange a security with a fixed return, did it appear that very large profits had accrued. In fact, the dividends of the Continental Co. were soon increased to ten and afterward to sixteen per cent. The profits to those who had assumed control of the Consolidated Company were correspondingly great; inasmuch as they received all the surplus income over the fixed returns given in exchange for the old securities. It is the possibility of such shuffling as this which has rendered the bonds of the Consolidated Company so unpopular that recent plans for their retirement have been consummated.

Excessive profits to the management or to banking syndicates from the manipulation or exchange of one security for another are exemplified in still another way in the notable case of the United States Steel bond conversion scheme. This complicated affair is sufficiently described in our reprint, so that further comment upon it is perhaps unnecessary.[1]

Overcapitalization is one of the most frequent, time-honored and persistent charges brought against industrial combinations and against corporations particularly as distinct from other forms of business organization.[2] The general public avers, in behalf of its interest as consumer, that while of course there is no direct relation between capitalization and prices, an excess of securities craving dividends is in itself an indirect incentive to unreasonable charges. An even more cogent objection than this is that the absence of any direct relation between investment value and the volume of stocks and bonds confuses all parties concerned. This was an underlying motive in the enactment of the Massachusetts Anti-Stock-Watering Laws of 1894. For a divergence between the actual property value and capitalization may lead to exorbitant prices and dividends at the expense of the public.[3] It invites unearned profits on the part of promoters leading to corporate organization or financial readjustment in unnecessary or unmerited instances. It stimulates extravagance on the part of banking syndicates in the prices

[1] Chapter VIII, pp. 149 *et seq.*

[2] On this topic see Chapters VI, VII, XV, XVI and XVII.

[3] For recent state legislation along this theory consult E. D. Durand in *Yale Review*, Vol. XII, p. 412.

offered or paid for constituent companies. It facilitates internal mismanagement, even promotes actual fraud, by the ease with which the most alert stockholders may be confused as to the real standing of their own company. And finally, it invites speculation and stock market jobbery among the public by the relatively small capital necessary to deal in, or acquire control of, considerable blocks of stock. It is certainly difficult to trace a direct relation between capitalization and prices. In most cases, probably, the evils ascribed to overcapitalization are merely concomitant rather than resultant. In other words, overcapitalization is often merely an indication of financial recklessness, which makes itself known coincidently in other phases of corporate conduct. There can be no doubt that most of the industrial combinations launched in 1899–1901 were seriously open to most of these criticisms. The belated experiment of the International Mercantile Marine Co., hereafter described in these pages, serves as a good illustration of such reckless financiering in recent years. Later developments, however, are tending to show that the lessons of overcapitalization are being impressed upon both promoters and the investing classes. Experience is proving that in the long run the conservatively capitalized companies alone can command banker's credit, weather periods of fiscal strain and hold the allegiance of investors. Consequently a number of large companies have voluntarily, or in the process of reorganization, reduced the volume of their outstanding securities. The National Lead Co. in 1891 reduced its capitalization from ninety to thirty million dollars. The Distillers' Securities Corporation now has less than half the amount outstanding against its predecessors. Only recently the New England Cotton Yarn Co. has eliminated the good-will item from its accounts, thereby reducing the totals on its balance sheet by about five million dollars. The American Ice Co. represents its condition in the following words of its own president: "It is clear that the capitalization is excessive; that the common stock represents no earning capacity even under normal business conditions." Other recklessly promoted companies now find themselves similarly placed. Such elements in this evil as are not self-remedying through bitter experience may be most success-

fully treated by means of laws insuring full publicity and accountability on the part of promoters.

What is the effect of industrial combination upon *prices?* No candid observer can deny that monopoly price where possible is much higher than the price level under competition. The price of sugar, for instance, as Jenks has pretty conclusively proven, has been effectively maintained at a high level, despite improvements in manufacture in which the public would probably share through declining prices, with the market an open one. In the same way the price of petroleum products has been successfully upheld by the Standard Oil Co. in the face of declining costs of manufacture. Miss Tarbell has shown in a convincing way how the market has been controlled at the expense of the consumer. In addition to such facts as these, it is unquestionable also that the producer of raw materials has likewise suffered under the industrial tyranny of the Standard Oil Co. Both markets, alike for the raw and finished product, have been absolutely controlled. The tendency is for the margin between crude and refined oil to increase steadily — wherefrom, of course, arises the enormous profits of the company. In the coal famine of 1902–03 the price of crude oil advanced as a natural response to the situation; but the price of the refined product was arbitrarily raised, not proportionately, but to a point which demonstrates clearly the menace to public welfare which the continued existence of the monopoly involves. The same allegations seem to hold true also of the great monopoly which controls the beef and meat packing interests of the country. There again an augmentation of price to the consumer appears to be joined with a relative depression of price to the cattle raiser. Other instances of the maleficent influence of monopoly in thus controlling staple industries are less rare than they should be.

This extremely evil condition of affairs is fortunately not characteristic of all the lines of industry wherein industrial combination has been attempted. Perhaps this is because the monopoly is less complete, competition having arisen under the prevalence of abnormal prices; or it may be due to the fact that

other commodities, not being staple and necessary to life, are exposed to the dangers of substitution of some other commodity produced in a more open market. The most serious evil in respect of monopoly price is often not its high level absolutely, but its arbitrary inequality as between both persons and places. Absolute control also implies possibility of manipulation. It has frequently been maintained by advocates of combination that a far greater steadiness of price will usually result. This plea has been exhaustively analyzed in a number of instances. Miss Tarbell discusses it in respect to petroleum products, and Jenks has investigated the course of prices in sugar, whiskey and other commodities produced under monopolistic control. In all of these cases it has been proven that sudden and violent changes of price are no less apt to occur than in an open market. The cause in such a case is, of course, often different from that which obtains under free competition. But the fact is that prices may be suddenly lowered in a locality in order to destroy independent local production; or that discrimination between persons is made to effect the same end; whereas, formerly, prices rose and fell because of a fluctuation in the general relations of demand and supply. On the other hand, certain combinations, like the United States Steel Corporation, seem effectively to have withstood an undue depression of prices during the industrial relapse of 1903–04. Whether they could have done this without the intervention of pooling agreements, which enabled them to include independent producers in their general programme, is not as yet clear. Perhaps, also, the monopoly prevented an abnormally high price level in the "boom" which preceded this collapse. That the general level of prices in iron and steel products — steel rails, for example — has been artificially supported during 1904–05, scarcely admits of reasonable doubt.

A brief outline of *possible remedies* for the present evils of the industrial situation may properly begin with the assumption that so far as individual repressive action by the separate states is concerned, the limit of legislative activity has about been reached. State anti-trust laws have been enacted everywhere and in all degrees of severity. The utmost that the separate

states can do is perhaps indicated by the laws of Massachusetts, making provision for publicity and general supervision.[1] The charter-bartering abuses rife in New Jersey, Delaware, Maine and West Virginia, by which states confer rights upon corporations to do things in other states, forbidden by the laws of those states, can be abated only by Federal decisions like the Northern Securities case.[2] Even under them, the most that could be accomplished would be for each state to purge its own territory of the nuisances committed by its neighbors, through taxation, licenses or other means. It becomes increasingly apparent that all effective remedies must be applied by the Federal government. As commerce becomes ever wider in its range, so must legislation proceed from a source of authority equally great and comprehensive. A delegation of greater powers to the states from the central government would only increase the present complexity of the situation.

The discussion of feasible remedies may also be facilitated by eliminating those measures which would require an amendment of the Constitution of the United States.[3] Simpler means should be first tested as to their efficacy. The Northern Securities decision has cleared the way for a trial of several of these. Another elimination may also be made of projects for merely strengthening the present prohibitory features of the Sherman Act. It is now good legal opinion that the English Common Law is almost as effective as that or any other similar statute against the evils of unfair competition and conspiracy in restraint of trade.[4] Reduction of some of our absurdly prohibitory tariff duties would surely accomplish much in abating monopolistic prices, either under permanent combinations or temporary pooling agreements.[5] But that question is so compli-

[1] Consult Chapter XV, pp. 382 *et seq.*, also p. 121. E. D. Durand, in *Yale Review*, Vol. XII, pp. 409–428, outlines new legislation since 1901.

[2] Chapter XIV, pp. 322 *et seq.*

[3] Compare 56th Cong., 1st Sess., H. R. 1501. Report of the House Committee on Judiciary on proposed amendment to the Constitution.

[4] Hon. E. B. Whitney, in the *Yale Review*, May, 1904; compare also pp. 230 *et seq. infra* Bruce Wyman of the Harvard Law School proposes an application of the Law of the Public Callings in *Harvard Law Review*, Vol. XVII, pp. 156 and 217.

[5] *Vide* pp. 289 *et seq.;* and also p. 54, and Jenks, Trust Problem, p. 44; and *Political Science Quarterly*, September, 1904.

cated by other issues and interests that effective action will require a profound modification of present public opinion. Hopeful signs that some relief in this direction may be soon granted are not wanting; although one may doubt whether anything very radical in tariff revision will be accomplished in the near future.

The most direct lines for remedial legislation are indicated by the proposals of the former Attorney-General of the United States as herein reprinted.[1] His drastic suggestion of a prohibition of interstate transport of commodities produced by monopolistic combinations was embodied in the Littlefield bill which passed the House of Representatives in February, 1903. And the prohibition of use of the mails would seem to be rendered more practicable since the recent Supreme Court decisions in the Lottery cases.[2] Certainly the necessity for amendment of the Interstate Commerce Act to prevent a continuance of the evils of secret rebates and preferential tariffs is well recognized. The Elkins amendments of 1903 have accomplished some good, but much yet remains to be done. Several bills are now prominently before Congress for action, being manfully supported by President Roosevelt. The field of possible legislative action is thus narrowed to three distinct proportions. Of these, the first is incorporation under Federal law. This plan, originally proposed by Mr. James B. Dill of the New York bar, has the approval of eminent corporation lawyers both in and out of Congress.[3] Such a law must needs be permissive, not mandatory; but it is urged that sufficient legal privileges and immunities could be offered, to induce large corporations to accept charters directly from the Federal government. The second of our remaining remedies is somewhat analogous. This is the recent proposition by Hon. James R. Garfield, Commissioner of Corporations in the newly organized United States Bureau of Corporations in his annual report for 1904. He suggests the granting of a Federal franchise or license for permission to engage in interstate commerce; prohibition of all such

[1] pp. 280 *et seq.*

[2] *Vide* p. 274 *infra.*

[3] Consult especially the discussion and proposed bill of Professor H. L. Wilgus in the *Michigan Law Review*, Vol. II, 1904, at pp. 358 and 501. Also opinion of Counsel of the U. S. Industrial Commission, Vol. XIX, pp. 686–722.

commerce to unauthorized corporations; full protection of the grantees of such licenses; and the requirement of such administrative supervision and publicity as may be reasonable. This last provision immediately brings us to our third remaining proposition for remedial legislation, underlying in principle all the others, — publicity.

Reasonable publicity should constitute an important feature in any well-ordered scheme of legislation. Its importance has never been duly recognized in any of the drastic state anti-trust laws thus far. The aim in such laws has been to prevent the occurrence of monopoly by prohibiting it under severe penalties. But the difficulty in the application of such laws has always been to prove the existence of the monopoly. The laws have fallen short in this regard. They have aimed to perform a work of supererogation. For, proof being given, any conspiracy in restraint of trade could in large measure have been condemned under the established rules of the English Common Law. Publicity enters at this point to supply the deficiency in the remedy, as well as to render the growth of the evil more difficult in first instance. For a proper degree of publicity as to the conduct of large businesses will speedily reveal the existence of abnormal sources of income. It will protect the consuming public and individual rivals in this way; and at the same time it will afford some guarantee of security for the investing public against internal financial rottenness. The dishonest promoter, director or banking syndicate flourish only in the secret recesses of corporate finance. For these reasons the successful establishment of the United States Bureau of Corporations in 1903 marks a long step in advance. Much yet remains to be done. Information gathered by this bureau ought within reasonable limits to be open to the public, and especially to stockholders; instead of being as at present reserved to the administrative use of the President of the United States. And action looking to the same end should be taken also by the separate states.[1] The goal is certainly not yet reached; but no

[1] F. E. Horack, The Organization and Control of Industrial Corporations, gives a most elaborate *résumé* of the provisions for securing publicity in the different states of the United States.

one can doubt that a reasonable publicity and administrative supervision for railroads and great industrial monopolies, akin to that now applied to National Banks, will be realized in due time. No other single remedy for the evils of monopoly can hope to accomplish results of equal importance.

Three steps have already been taken in the path of reform. The Elkins amendments to prevent secret discrimination in freight rates, the law facilitating the progress of anti-trust suits in the Federal courts, and the establishment of the Bureau of Corporations have all been secured within two years. With a revised tariff and an amended Interstate Commerce Act in 1905 the present administration would justly have reason to be proud of its services to the nation.

WILLIAM Z. RIPLEY.

TRUSTS, POOLS AND CORPORATIONS

I

THE MICHIGAN SALT ASSOCIATION[1]

WITHIN the last half-century, the amazing comparative growth of capital as a factor in production; the combinations of workingmen arising from their forced association in manufacture according to modern methods, and the ensuing discontent — or rather, the frequent and increasingly emphatic expression of discontent — with their lot on the part of the workingmen, as combination has increased their sense of strength; the combinations of capitalists and the startling revelations of power afforded by such organizations as the Standard Oil Company and the coal syndicates of Pennsylvania, — all these things have lent to the study of combinations among either capitalists or workingmen, or of cooperative unions of the two, an especial interest. More frequently the subject has been studied with reference to workingmen, the advantages and disadvantages to them; but it seems no less desirable, from the standpoint of the economist at least, that combinations among capitalists, either for purposes of protection against unreasonable demands of workingmen or for their own interests as producers, should be studied; and that the investigation should cover the influence of such combinations on the consumers as well as upon the capitalists themselves.

The story of the Standard Oil Company has been told more than once, in words eloquent with the conviction of the danger threatening our government and civilization from the growth of such corporations. The consumers of anthracite coal throughout the United States during the past two years, have needed

[1] From the *Political Science Quarterly*, Vol. III, 1888, pp. 78–98.

no publicist to tell them that some powerful influence has been brought to bear upon the price of this product. Although far less in power than either of the combinations mentioned, the Michigan Salt Association, from the extent of its influence over the price of an article of food so common and so necessary as salt, as well as from the magnitude of its operations and its great and apparently increasing power, seems to be a fit subject for a study of this kind. The extent of the influence of the association may be noted, when we consider that Michigan produces more than 40 per cent of all the salt manufactured in the United States, and that, of the Michigan product, not far from 95 per cent will be sold by the association during the coming year. In short, speaking generally, the price of the salt consumed in all the Northern states west of Pennsylvania and New York, until we approach those bordering on the Pacific ocean, is the price set by the managers of this association. It is the purpose of this article to give a short sketch of the history of this combination of manufacturers, with that of others which preceded it; to describe its plan of organization and its work, and to estimate the influence which it has exerted and that which it can exert on the price of salt.

The early settlers of Michigan had learned from the Indians of the existence of many salt "licks," or springs, in different parts of the state, and it was thought even by them that there was an opportunity for the growth of a great industry in its manufacture. In 1838 Dr. Houghton, the state geologist, called the attention of the legislature to these facts, and suggested that an appropriation be made for the sinking of test wells. The time was propitious for such a request. The newly adopted constitution had declared: "Internal improvements shall be encouraged by the government of this state;" and the governor had been authorized by the ambitious first legislature to borrow on the credit of the state the sum of $5,000,000, to constitute an internal improvement fund.[1] From this fund $3000 were at once appropriated; the next year $15,000 more, and small sums in succeeding years. While salt was found, the wells were not sunk deep enough to yield brine in paying quantities.

[1] Cooley, Michigan, ch. xiv. [American Commonwealth Series.]

In 1859, an act was passed exempting from taxation all property used in the manufacture of salt and offering a bounty of ten cents per bushel on all salt made in the state. A corporation, the Saginaw Salt Manufacturing Company, was formed the same year in East Saginaw to put down a well and engage in the manufacture of salt. So little was known, even by the board of directors and officers of the company, regarding the character of the work, that it was necessary for a committee to visit the Onondaga salt works to learn what buildings, machinery, and tools were necessary for boring the well. But by February 7, 1860, the directors felt warranted in making a report to stockholders, declaring the work a success. In March the well was completed; another one was immediately put down; and manufacture began in July. The works were thrown open for inspection July 4. In this first year, 1860, about 4000 barrels of salt were manufactured.[1]

As soon as it became known that brine of paying quality and quantity was to be found in the valley, capital was rapidly invested. In 1862, 243,000 barrels were made, and in six years there were engaged in the manufacture of salt in the Saginaw valley, sixty-six different companies with an investment of nearly $2,000,000.

TABLE I

ANNUAL SALT PRODUCT OF MICHIGAN, 1860–1886

YEAR	BARRELS	YEAR	BARRELS
1860	4,000	1874	1,028,979
1861	125,000	1875	1,081,865
1862	243,000	1876	1,462,729
1863	466,356	1877	1,960,997
1864	529,073	1878	1,855,884
1865	477,200	1879	2,058,040
1866	407,077	1880	2,676,588
1867	474,721	1881	2,750,299
1868	555,690	1882	3,037,317
1869	560,818	1883	2,894,672
1870	621,350	1884	3,161,806
1871	728,175	1885	3,297,403
1872	724,481	1886	3,677,257
1873	823,346		

[1] Statistics relating to the Saline Interests of Michigan, by S. S. Garrigues, Ph.D., State Salt Inspector; Lansing, 1881.

This table shows, in the falling off of the yearly product, 1865–1867, the result of the rapid and in many instances ill-advised investment of capital. Under the conditions obtaining at the time, unrestricted competition soon drove the weaker companies to the wall. In those days, the extent of the salt-producing territory and the methods of manufacture were less well known, and the business was much more of a natural monopoly than now. Under these circumstances, the solution of the difficulty was evident: combination was indicated and combination soon appeared. In a statistical summary of the leading products of the Saginaw valley, published by *The Saginaw Daily Enterprise* in 1867, we read: "This interest [salt] is somewhat under a cloud at present through the evil influence of speculation and inconsiderate management." Then, farther down the page come, as one might expect, the words: "At least two-thirds of those [blocks] now running turn in their production to the Saginaw Salt Company." Thus, as early as 1866, six years only after the industry was started, we find that many of the manufacturers were uniting their interests so far as the sale of the product was concerned.

Soon, from individual agreements the leading firms came to something more stable and far-reaching in its influence. On the 16th of April, 1868, the articles of association of the Saginaw and Bay Salt Company were adopted. The first year of its existence, this association handled four-fifths of all the salt shipped from the Saginaw valley. Its benefits to the manufacturers, as well as to the consumers, — so far, at least, as the quality of salt is concerned, — were at once recognized, and are clearly set forth in the *Statistics of the Saginaw Valley* for 1868:

> The operations of this company have been completely satisfactory, and the organization is unquestionably of great benefit to the salt manufacturers who have availed themselves of the advantages it offers. It has, so far as its line of operations has extended, brought about the one thing needful, a uniform system of inspection, and introduced system, order and reliability into a business, which, without such general regulations, has in no quarter ever proved remunerative.

In spite of the competition of New York and the Ohio river (relieved in part by an agreement with the Onondaga Salt Com-

pany which will be considered later), the business grew with remarkable rapidity, and the association ran smoothly till 1871, when the vigorous efforts of some of the members opposed to the management became of serious moment. The real merits of the controversy, which became bitterly personal, several letters of a violently abusive character being published, it is hard to determine. On the one side, charges of mismanagement, even of dishonest practices, were made against the officers of the association by Duncan Stewart, president of a salt manufacturing company; on the other, Stewart's dissatisfaction was said to have been caused by the refusal of the managers to ship salt by a line of boats in which he was interested, at rates above those offered them elsewhere. For our purpose it is enough to know the result. In the *Annual Statement* of the business of the Saginaw valley for 1871, we find it in compact form:

> In salt, the season of '71 may be quoted as of extra activity both in manufacture and sale. Early in the season it became evident that a commercial rivalry had been excited which could not end but by the going to the wall of one of the parties engaged in it. Assuming the shape of individual antagonism to a corporate company, it became at an early day evident that many of the manufacturers who are members of the Salt association, would take sides with the opponents of the association, and as a result fully one-fifth of the entire salt product of the valley, which under ordinary circumstances would have been handled by the association, was purchased by the firm of J. L. Hurd & Co., of Detroit, at prices in advance of those realized by those who remained in the association. Since the close of navigation, the association has resolved to suspend operations for the present, and each manufacturer will, during the season, be left free to realize as best he may on his products.

It is significant, and somewhat surprising to note that by the determined efforts of one man, the association was forced to suspend operations, even though, as has been reported, this man was compelled to destroy his own financial standing to bring about such a result. Table I, again, furnishes us with an interesting comment upon this financial battle. For 1872 the production of salt in the state is more than 3600 barrels less than that of the year preceding; whereas both 1871 and 1873 show a gain of about 100,000 barrels.

Five years passed before a thoroughly effective union could again be made. Smaller organizations were formed to sell salt for groups of manufacturers, notably the Saginaw Salt Association and the Michigan Salt Association; but the competition was fierce, prices went steadily down, and the weaker companies found themselves in need. At length, after low and declining prices throughout the year 1875, the time seemed ripe for another organization which could control the sale of a large proportion of the Michigan salt, and through this added power of union both secure a saving in the expenses of sale and transportation, and either compete more effectively with the New York and Ohio river manufacturers or force them into a union which should control the whole American product. January 8, 1876, J. E. Shaw, president of the Michigan Salt Association (a smaller combination of manufacturers), issued a circular address to the salt manufacturers of Michigan, calling a meeting to be held at Bay City, January 20, to effect such an organization, if it should be possible. The address exhibits in an almost pitiable light the situation of the manufacturers, and urges strongly the need of organization. Mr. Shaw declared:

The old adage, "in union there is strength," is true wherever you apply it, and in manufacture of salt there is no exception. To secure this *union* with its attendant *strength* is the object of the Michigan association. This is the object it had in view when it was organized, and this is the object it has in view to-day. That the organization has remained inactive, is attributable to the fact that it could not secure control of a sufficiently large *percentage* of the state product to warrant [aggressive action], a few manufacturers declining, for reasons best known to themselves, to enter the association. And what was the result? Salt has depreciated in value, dropped steadily down, until to-day it has no market price on the Saginaw river, and is quoted at only $1.27 in Chicago, and $1.00 in Toledo. That the experience of '75 will be that of each succeeding year, unless something is done to check the general demoralization, cannot be gainsaid. The oldest manufacturers of the Syracuse, Kanawha, and Ohio districts, tell us that their experience, dating back forty years in some cases, has *always* been this: "*Organized we have prospered. Unorganized we have not.*" This is the experience which we have been buying and paying dearly for. . . . The trouble lies in the *marketing* of the product. Each man has taken care of (or

attempted to) his own product. . . . The other salt districts of the United States are now organized, and are ready to treat with us (as soon as we have an association) relative to fixing and maintaining prices, dividing the territory, and making other arrangements which will inure to the advantage of the trade. But we must first be organized. They cannot treat with individuals.

The appeal was successful. The meeting was held; others followed; and in April the Saginaw Salt Company and the Michigan Salt Association were consolidated and other outside firms were taken in, so that from the beginning more than 85 per cent of the product of the state was controlled. The new association took the name of The Michigan Salt Association.

When in 1881 the association expired by limitation, it was immediately reorganized under the name of The Salt Association of Michigan; and, in 1886, again expiring by limitation, it was again organized under its former name. The three associations have been, in fact, the same association under different names; the president and secretary elected in 1876 still hold their offices, and the business is conducted on the same principles, slight changes only having been made in the articles of association and by-laws.

The organization of the association, effective as it is, is very simple. Less than a page contains the articles of association, which declare that the purpose of the association is "the manufacture and dealing in salt," and the "transportation of its products to market"; that the amount of capital stock shall be $200,000, divided into $25 shares, of which the amount actually paid in is two dollars per share; that its affairs shall be managed by a board of nineteen directors (of whom not more than one shall be from the same firm or company of manufacturers) chosen by the stockholders; that the offices for transaction of business shall be in East Saginaw and Bay City, and that the business shall be carried on in the salt-manufacturing counties; and, finally, that the association shall exist as a corporation for the period of five years.

From the by-laws, we learn that the stockholders shall be manufacturers of salt, and that the number of shares taken by any one "shall not exceed one share of the capital stock for

every barrel of the average daily capacity of his manufactory on a fair estimate" — an excellent provision to prevent manipulation of stock to the detriment of the real business.

An annual dividend of seven per cent payable semi-annually on the amount of stock actually paid in, together with the losses, costs and expenses incurred in handling and selling, including the state inspection fees, is deducted from the proceeds of sales before division is made.

That the business management of the association may be as personal and direct as possible, the president is given the general supervision of the entire business, subject to the general rules laid down by the board and the executive committee. A secretary and a treasurer with the usual duties of such officers are appointed by the board, and also an executive committee, which has general control and is charged with the duty of auditing all accounts, inspecting all books, etc., at least once a month. The officers receive a stipulated salary. The organization, it will be seen, is such that the executive efficiency of a single head is combined with all proper checks to guard against any abuse of trust on the part of any of the officers. The fact that the chief officers of the association have held their positions since its organization, and the continued prosperity of the association, never greater than now, reflect the greatest credit on the management as well as on the authors of the plan.

The relations of the association with the members, however, constitute the main point of interest. A contract is made *every year* with each manufacturer who wishes to become a member, in accordance with Article vii of the by-laws, which reads as follows:

Every manufacturer, in becoming a member of this association, shall execute and deliver to it a contract for all salt manufactured by him or them, or a lease of his salt-manufacturing property, including all apparatus and appurtenances thereunto belonging, for the purpose of manufacturing. Such contract or lease shall be for the term of one year, or until the dissolution of the association, and shall not impose any restriction that will prevent the manufacture of salt at any and all times.

Each and every contractor shall manufacture salt for this association on the terms and conditions as follows:

That he will make salt solely on the association's account, of the best quality of the kind manufactured by him, according to the conditions of his contract or lease.

The contracts provide, further, that in case the manufacturer sells salt on private account, he shall pay to the association ten cents for every barrel so sold; that the contract, however, is not thereby forfeited, but remains in force throughout the stipulated time.

While this gives full control of the product to the association, and effectually prevents all competition among the manufacturers, the provision that no restriction shall be imposed which will prevent the manufacture of salt at any and all times, operates powerfully against any raising of prices to exorbitant rates such as might perhaps be secured otherwise, if combination with the New York and Ohio river manufacturers could be effected. The reason that this clause stands in the by-laws, and that the practice of the association differs so entirely, on this point, from that of the anthracite coal syndicate and other combinations of like character, is found in the peculiarity of the manufacture. A great part of the larger salt blocks are run in connection with saw-mills; and the slabs, sawdust, etc., from the mills are used for barrels and fuel. Not only would this material, if not so used, be a dead loss, but its removal would be a source of expense. Manufacturers so situated could never expect a rise in the price of salt sufficient to compensate them for the loss that would be incurred in stopping their works; and consequently they will not join the association unless assured that they will not be subjected to such a loss and inconvenience in their more important business.

Another provision of great advantage, especially to the manufacturer of comparatively small capital, is that which provides for an advance of money on all the salt inspected each month, whether the salt is taken from the bins and sold or not, if the manufacturer wishes such advance and is willing to pay interest on it. The rate of advance and the rate of interest are fixed by the board and may be changed from time to time; but liberality is always shown both in the amount advanced and in the rate of

interest. The advance has been lately 25 cents per barrel in the bins, or 45 cents per barrel if packed, with interest at 7 per cent. Money may be loaned in the state at 10 per cent, and this rate is often obtained on small sums for short periods of time.

The salt becomes the property of the association as soon as inspected; but the manufacturer is still bound to deliver it free of charge on the wharf or on the cars, as the association shall direct, and to sustain all losses by fire or otherwise, if they occur before such delivery. The association agrees on its part to remove within a reasonable time all the salt manufactured.

Reports are rendered every month to each member of the association, giving not merely his own special account, but all the sales, with the average price both gross and net, and all the necessary expenses with principal items — average freight, commission, home and storage charges, etc. All the members receive credit at the same average rate, and for an amount proportioned to their manufacture as shown by the inspection — a provision greatly to the advantage of the poorly situated companies. The receipts of salt for each month are sold and accounted for separately.

The association keeps its agents — most of them selling on commission, but some on salaries — in Chicago, St. Louis, Cincinnati, Cleveland, Columbus, Duluth, Detroit, Milwaukee and other places, wherever this is warranted by the amount taken.

It will perhaps be well, further, to notice some attempts that have been made, since the manufacture of salt in Michigan became a leading industry, to form combinations of all the leading manufacturers in the country, and thereby to secure from consumers a price limited only by the competition of foreign salt and the lessened demand consequent on the rise in price.

Not many months after the Saginaw and Bay association was formed (April, 1868), the managers began negotiations with the manufacturers in New York and in the Ohio river district. This first attempt, instead of resulting as had been hoped, led, from a rather peculiar combination of circumstances, to an even fiercer competition than had existed before.

The president of the association gives the facts in his report of 1870 to the board of directors. The association in Michigan

succeeded in making terms with the Onondaga Salt Company, but failed with the Ohio river association, because the latter could not control the product of their district either as to quantity or price. Some new works at Pomeroy, it seemed, had refused to join the Ohio river association. The other manufacturers of that district, having sold *all their product* to the association *at a fixed price*, increased their output and flooded the market. As the association could not control the works at Pomeroy, there was a general cutting of prices in which, of course, Michigan and New York were compelled to join. As the eloquent writer puts it: "It was a Donnybrook Fair in the salt market. When you saw a head, you hit it." The immediate result was, naturally, detrimental to all the works. The final outcome was that the outsiders on the Ohio river joined the association, and a change in the character of the contract with the former members enabled that association to control the *quantity* as well as the price in that quarter. This being done, it became an easy matter to make the combination general. The Washington correspondent of *The Chicago Tribune* gave an account of the pool which is corroborated by other papers and by officers of the present Michigan association. The Syracuse, the Ohio, and the Saginaw and Bay companies entered into an agreement at Detroit, March 22, 1871,

To make a pool of all the salt in the market in the territory bounded by the lakes on the North and East and by the Ohio river on the South, the western and southwestern boundary to be entirely discretionary, according to the prices of freights to places whence orders for this article might be sent. This discretion was confided in a board, there appointed, which consisted of one representative from each of the three salt corporations, who are also empowered to fill orders and forward all supplies, to advance or reduce prices as occasion may require. The percentage of the pool, and all future supplies and profits under existing arrangements, were agreed to as follows: Syracuse, 40 per cent; Ohio river, 32 per cent; Saginaw, 28 per cent.[1]

The prices fixed were $2.00 per barrel for Chicago, Cincinnati, Cleveland and Detroit; $2.10 for Toledo; and $2.40 for St. Louis.

[1] *The Chicago Tribune*, April 4, 1871.

Reference to Table II (see page 15) will show the effect of the "Donnybrook Fair" period, as well as the rise in price consequent on the pool in 1871. The Chicago prices of the first of January show the effects of both movements, as do also the average prices at Saginaw. Gold prices show a less decrease, but emphasize the rise in 1871–2. At the close of 1871, as we have seen, the Saginaw and Bay association, having lost control of a large proportion of the Michigan men, could not uphold their end of the bargain. As they were not bound, however, to take *at a fixed price* any large product, no such immediate cutting of prices followed as had been seen the year before.

A somewhat more firmly controlled pool was made ten years later to cover about the same territory. A special arrangement was made with the Ohio river manufacturers, the exact terms of which cannot be given; but they are of little consequence, since by far the larger part of the amount was sold by the other companies.

The territory covered was bounded on the east by a line drawn north and south through Buffalo, and on the south by the Ohio river, as before. The importance of the Michigan product, relatively speaking, is worthy of special notice. In 1871, as we have seen, Michigan put in 28 per cent; Ohio river, 32 per cent; and New York, 40 per cent. In 1881, Michigan put in $\frac{15}{17}$ and New York $\frac{2}{17}$, while some special arrangement regarding a small fixed number of barrels, or a fixed rate, was made with the Ohio company. The management of the pool, as before, was confided to a committee selected from both companies. The contract went into effect May 1, 1881, and was terminated March 1, 1882, a month's notice having been given by the Michigan association in accordance with the terms of the contract. The effect of the pool on prices is shown in Table III (page 16). The cause for the breaking of the pool, and the following sudden lowering of prices, is stated by the managers of the association to be simply that the markets, especially Chicago, had become overstocked with salt, and the Michigan association felt the need of having full control there. They broke the pool, and "slaughtered the market."

Though other combinations have been talked of at times, no other has been made.

Such, in brief, is the history and the plan of organization of The Michigan Salt Association. It remains to consider somewhat more fully its economic effects.

First, much credit must be given the association for the improvement of the quality of the salt manufactured in the state. The necessity for a rigid system of inspection to keep up the quality of the product and prevent injury to the reputation of Saginaw salt in the market, led the old Saginaw and Bay Salt association to appoint a committee in 1868 to draft a law meeting the wants of the salt manufacturers. As early as 1865 a system of local inspection had been adopted by a number of manufacturers,[1] but something more rigid was required; and this bill, which became a law in March, 1869, was the result. As amended in 1875, it remains to-day in the statute book, and to it is doubtless due in large measure the superior quality of the Michigan salt.

The inspector is appointed by the governor and senate, is paid a stated salary by the state, and is, of course, entirely independent of the manufacturers. The state is divided into as many districts as seem to him practicable for the thorough carrying-out of the work, and all salt made is carefully inspected, a deputy inspector visiting each block *every day* for this purpose. The early association deserves the credit of securing this effective law. Some manufacturers, it is true, attempt at times to evade the law and to pass off an inferior grade of salt for the best; but the larger manufacturers, and of course the Salt association, are interested in having the grade of salt kept up, and therefore assist the work of inspection as much as possible.

The question which next suggests itself — that of the influence of the association upon prices and profits — cannot be answered so briefly. In many of the markets it is clear that the association is really without competition as long as it keeps its prices reasonably low, or perhaps we had better say, only moderately high. The effective competition of New York — or even that of any Michigan manufacturers who are "running

[1] S. S. Garrigues, Saline Interests of Michigan, p. 32.

wild" — is practically out of the question. It must not be forgotten that the average cost of manufacture in Michigan is considerably less than in New York; and though westward-bound freights are low, they are still worthy of consideration. Of course no single manufacturer could escape competition to so great an extent, since his neighbors would be his strongest competitors. Again, by means of its thorough organization and the daily reports sent to the home office by agents in all important markets, the association is able to make sales not merely more advantageously as regards price, but also with a much less expense in the way of commissions, travel, number of agents, etc. Besides this, the freedom from care and responsibility and the certainty that the product is in hands that will make the most of it, is worth not a little to the average manufacturer. The last-named item alone, that of greater intelligence and knowledge of the market, should receive more consideration than the manufacturer usually gives it.

Another point of advantage is this: by means of its large sales and long experience, the association can reduce losses from bad debts to a lower figure than could individual manufacturers.

Further, when the sales are all made from a central point, with a right to deliver from any of the manufactories at will, it is clear that a large saving in transportation can be made. Contracts will be filled always from the works most favorably situated. Vessels and cars can be secured at such times and places as will enable them to carry at the lowest rates. The average rate of freight is thereby much lessened.

The plan of advancing a large part of the value of the salt to the manufacturer before the salt is sold, enables him to carry on his business with less capital than would be required if he were not a member of the association.

The first consideration, the abolition of competition, comes solely to the benefit of the manufacturer; the others mentioned are advantages from organization which lessen the cost of production, — including sales and transportation, — and may benefit either the manufacturer, through greater profits, or the consumer, through lower prices, or the benefit may be divided.

A study of prices before the formation of the association, and

after, would seem to show that while the saving had chiefly benefited the manufacturer, as was to be expected, the consumer had not suffered seriously.

TABLE II

PRICE OF SALT PER BARREL IN SAGINAW AND CHICAGO

YEAR	SAGINAW	CHICAGO
1860, January 1,		$1.50
1861, Jan. 1,		1.75 @ 2.00
1862, Jan. 1,		2.25
1863, Jan. 1,		2.25
1864, Jan. 1,		2.10 @ 2.15
1865, Jan. 1,		2.75
1866, Jan. 1,		2 35 @ 2.40
1866, average,	$1.80	
1867, Jan. 1,		2.40 @ 2.45
1867, average,	1.77	
1868, Jan. 1,		3.25
1868, average,	1.85	
1869, Jan. 1,		2.60
1869, average,	1.58	
1870, Jan. 1,		2.25 @ 2.30
1870, average,	1.32	
1871, Jan. 1,		2.05 @ 2.10
1871, average,	1.46	
1872, Jan. 1,		2.35 @ 2 40
1872, average,	1.46	
1873, Jan. 1,		2.40
1873, average,	1.37	
1874, Jan. 1,		1.90
1874, average,	1.19	
1875, Jan. 1,		1.65
1875, average,	$1.10	
1876, Jan 1,		$1.35
1876, average,	1.05	
1877, Jan. 1,		1.40
1877, average,	.85	
1878, Jan. 1,		1.10
1878, average,	.84	
1879, Jan. 1,		1.10
1879, average,	1.02	
1880, Jan. 1,		1.45
1880, average,	.75	
1881, Jan. 1,		1.05
1881, average,	.83⅔	
1882, Jan. 1,		1.35
1882, average,	.70	
1883, Jan. 1,		1.00
1883, average,	.81	
1884, Jan. 1,		1.15
1884, average,	.75⅔	
1885, Jan. 1,		.95
1885, average,	.70	
1886, Jan. 1,		.95
1886, average,	.66	
1887, Jan. 1,		.80
1887, average,	.57½	

Table II shows that, while the prices have on the whole tended downward since 1876, the time of the formation of the association, the rate of decrease has been somewhat less rapid. On the other hand it must be noted that the prices in the earlier years are reckoned in legal tender notes. This causes the prices during the sixties, and the rate of decrease during the years preceding resumption, to appear greater than they really were, though a slight check in the rate of decrease can be seen even when prices are reckoned in gold. The influence of the war, too, in pushing the price to what was really an abnormal height, must not be overlooked. The improved methods of manufac-

ture would naturally cause a lowering of price, and it is impossible to accurately judge the influence of all the factors. The earlier prices, of course, were not determined to any marked extent by the Michigan product, as the manufacture in the state began in 1860, and was not really on an even footing with New York for several years. It seems probable, however, that the association checked somewhat the tendency toward a lower price, and, if so, the consumer is so much the worse off. This difference in price cannot on the whole have been much, the chief advantage to the manufacturer coming, probably, from the lessened cost of putting his product on the market.

It is, again, quite probable that without the association, the larger dealers would take part of the profit which now goes to the manufacturer, and that the consumer would be forced to pay as much as now, and even more. Certain it is that large dealers in Chicago, Toledo, Cleveland and Sandusky express themselves generally as opposed to any association, even when they have been appointed agents. At present they receive a low commission per barrel of salt sold; whereas, before the formation of the association, they could buy salt in the summer months when it was very plentiful, and store it till after the close of navigation, and then the few larger dealers in such an important market as Chicago, by uniting, could advance the price enough to reap a handsome profit. This practice, which was common, came to the benefit of the few dealers, while neither the manufacturer nor the consumer received any share.

TABLE III

Association Price of Salt each Month, from June, 1877, to November, 1887[1]

June 1877	$0.80¼	Feb. 1878	.70	Oct. 1878	.70
July "	.79	March "	.71	Nov. "	.70
Aug. "	.72½	April "	.76	Dec. "	.70
Sept. "	.74½	May "	.75	Jan. 1879	.72
Oct. "	.74	June "	.77	Feb. "	.80
Nov. "	.75	July "	.77	March "	.83
Dec. "	.80	Aug. "	.76	April "	.82
Jan. 1878	.73	Sept. "	.70	May "	.80

[1] Prices given are for the sales of the preceding month.

TABLE III — *Continued*

June 1879	.80	April 1882	.71	Feb. 1885	.69
July "	.86	May "	.72	March "	.68
Aug. "	.88	June "	.70	April "	.66
Sept. "	.90	July "	.70	May "	.63
Oct. "	.94	Aug. "	.70	June "	.62
Nov. "	1.02	Sept. "	.69	July "	.60
Dec. "	1.05	Oct. "	.69	Aug. "	.60
Jan. 1880	1.05	Nov. "	.69	Sept. "	.65
Feb. "	1.08	Dec. "	.70	Oct. "	.70
March "	1.09	Jan. 1883	.70	Nov. "	.72
April "	1.05	Feb. "	.70	Dec. "	.73
May "	.85	March "	.70	Jan. 1886	.71
June "	.72	April "	.70	Feb. "	.72
July "	.72	May "	.75	March "	.71
Aug. "	.72	June "	.80	April "	.70
Sept. "	.72	July "	.80	May "	.69
Oct. "	.72	Aug. "	.80	June "	.68
Nov. "	.72	Sept. "	.80	July "	.66
Dec. "	.72	Oct. "	.81	Aug. "	.65
Jan. 1881	.74	Nov. "	.83	Sept. "	.65
Feb. "	.77	Dec. "	.83	Oct. "	.63
March "	.77	Jan 1884	.83	Nov. "	.60
April "	.76	Feb. "	.83	Dec. "	.60
May "	.76	March "	.83	Jan. 1887	.60
June "	.76½	April "	.83	Feb. "	.60
July "	.81½	May "	.80	March "	.57
Aug. "	.88⅓	June "	.74	April "	.55
Sept. "	.92½	July "	.72	May "	.55
Oct. "	.94	Aug. "	.71	June "	.53
Nov. "	.95	Sept. "	.70	July "	.51
Dec. "	.95	Oct. "	.70	Aug. "	.57
Jan. 1882	.94	Nov. "	.70	Sept. "	.58
Feb. "	.99	Dec. "	.69	Oct. "	.60
March "	.99	Jan. 1885	.68	Nov. "	.62

Table III, giving the average monthly prices of the association (the net prices paid to manufacturers), shows, on the whole, a decline; but one not so great after all, when one considers the general tendency of prices of all manufactured products. Moreover, there are several times when the price has gone up enough to counterbalance in great part the decline.

Besides the statements of reliable manufacturers regarding their profits, a comparison of the table of prices with the table showing the amount produced in different years in Michigan

gives us still further reason for the belief that the association cannot secure prices which make the profits at all extraordinary. A distinctly marked rate of increase (not absolute increase) or falling off in production usually follows, especially in later years, like changes in the average yearly price. One should not lay too much stress, however, upon such similarities, as there are many other determining factors.

Many of the advantages to manufacturers of such an association, especially the freedom from competition with one's neighbors, cannot be secured unless a very large proportion of the manufacturers of the state are united. The association aims, of course, to have as many join as possible; and in case of necessity it does not hesitate to "squeeze" a manufacturer whose block is so situated that he has no need of the association, and whose competition is troublesome. This brings to our notice the disadvantage it might be to some manufacturers to become members. As the prices, freight charges, etc., are arranged for the whole association, the manufacturer who has a ready market near at hand could oftentimes realize somewhat more by remaining outside.

In the year 1886, about 600,000 barrels of Michigan salt were sold by outsiders. The amount was large enough to make a real competition that could be severely felt by the association. At length, the managers issued the order to their agents to meet any rates, however low they might run. Table III shows the gradual decrease, as the fight went on. In August, 1887, the unprecedentedly low price of 50 cents per barrel was reached. In the same month manufacturers representing some 350,000 to 400,000 barrels, yearly product, joined the association; and we note the consequence in the rise of price to 57 cents for that month's product, while the prices for the following three months (58, 60, and 62 cents) still show the upward tendency.

It has been impossible to obtain with any degree of accuracy the data which would indicate the influence of the competition within the state; namely, the times of the accession of different manufacturers to the association and of their withdrawal from it. As the contracts are made yearly, some enter the association

and others leave it every year. In one or two instances, however, the effect of such changes is marked. Reference to Table III shows, in 1880, a sudden decline in price from $1.09 to 72 cents within three months. This is probably to be explained by the fact that "a large number of the manufacturers went out March 1, and that they commenced cutting prices, and we [the association] concluded to more than meet them."[1] The sudden drop in prices in the early part of 1882 followed the breaking of the pool with New York. The rise in August, 1887, is due, as noted above, to the accession of a number of manufacturers. It should rather be called the setting back of the price toward that obtained before the cutting to force the manufacturers in. Doubtless, too, many of the other changes noticed are to be ascribed to the same causes.

When a barrel containing 280 lbs. of fine salt of the first quality can be bought in the Chicago market at a price ranging from 75 to 85 cents, there is not likely to be very much complaint on the part of consumers, nor much talk about "monopolies," "coalitions for robbing the people," etc.; and yet the Michigan Salt Association is sometimes attacked as a monopoly, and it doubtless has some of the features of one. Adolph Wagner is strongly inclined to recommend the manufacture of salt by the state, on account of the danger of so common an article of consumption being monopolized by the manufacturers and dealers.[2] The advisability of state control seems to him, on the whole, greater than in the case of the coal industry. Our experience with anthracite coal companies within the past few years has been such that we may well note the circumstances of our salt industry in this regard. Is it likely or even possible that a really oppressive monopoly in this article can be made?

The salt-producing territory of the United States, while widespread, is nevertheless so limited that competition in manufacture is by no means so free as in other lines where the raw material may be shipped in at low rates; *e.g.* cotton, or shoes. This makes it much easier for two or three combinations to unite

[1] Letter from the secretary of the association.
[2] Wagner, Finanzwissenschaft, Bd. I, §§ 251, 254.

and control the whole product; and we have seen that in two instances, at least, for short times, such a union was made to control "disputed territory"—an expression, by the way, which in itself emphasizes the limited nature of the competition.

The coal and petroleum industries have been able to secure complete control by the aid of the railways. Aside from the fact that the capital invested in salt is much smaller, it would be much more difficult for the associations to control the means of transportation. The territory is more widely scattered, and is, besides, much of it adjacent to the great lakes. Such a control as the coal syndicates exercise, would require a controlling influence over all the larger railways east of the Mississippi, and over the boats on lakes Huron, Michigan and Erie, as well.

A further matter to be noted is the large import of salt. In 1880 some 38 per cent of all the salt used in the United States came from abroad. Though part of this is of a different quality and does not enter into competition with the American product, yet a large part of the sea-board traffic in salt, and the larger part of the salt used in the South, is controlled by the importers. The salt is brought as ballast, so that the cost of transportation to our coast is practically nothing. It is the cost of transportation from the sea-board that keeps it out of the territory now controlled by the Michigan association. It may be readily seen that our protective tariff on salt would need to be far higher than at present, before our manufacturers, even if all in the United States were united, could command prices comparable, when considered with reference to the cost of production, to those obtained on anthracite coal. The character of the combinations, too, would need to be much stricter.

Without such combinations, considering the Michigan association as it is, the New York competition is enough to keep the price from becoming exorbitant. Add to this the above-mentioned fact that the association has no power to limit production, and the fact that new wells are being sunk continually, whose owners can be forced to join the association, if inclined to remain outside, only by a tedious and expensive fight on prices, and the dangers to consumers from the association seem slight. Doubtless, the manufacturers who have been in effect

forced into it, and who feel that without an association in the state more profit could be made, are inclined to think that such a combination is oppressive. These manufacturers, however, form but a small proportion of those in the state.

The conclusion to which one must come, then, regarding the influence of the association is this: it is probable that the average consumer is but slightly affected, though it is possible that he has to pay a little more for his salt than would otherwise be the case; it is certain that, with the exception of a few who are uncommonly well situated, the manufacturers are decidedly benefited by the association. Certain it is that most of them are well content, and that the association never stood firmer than it does to-day.

J. W. JENKS.

The subsequent history of combination in this industry has been unfortunate. The National Salt Company was organized in New Jersey in 1899, acquiring the business of a company of the same name chartered by West Virginia. Most of its properties were in New York, but the company purchased the best plants in Ohio and Michigan, claiming in 1900 to include 94 per cent of the evaporated salt of the entire country excepting the Pacific coast. In 1900 plans for controlling salt works in Spain and Italy were inaugurated.

The next step was the formation of a New Jersey company in 1901, known as the International Salt Company, which absorbed the National by interchange of securities. This operation was financially tainted by the enormous compensation, amounting to about one-third of the stock of the new company, issued to the promoters By 1902 also it became clear that the National Salt Company, which had been paying dividends at 8 per cent on the common stock, was practically insolvent, not even having earned interest on its bonds. It was officially stated that this embarrassment was due more to extravagant purchases of plants than to losses in operation. Meanwhile disorganization and losses of property under receivership has greatly reduced the proportion of the entire industry controlled. In so far as the possession of natural salt deposits constitutes a basis for monopoly, a foundation for successful combination would seem to be present; but failure has evidently resulted hitherto from a combination of extravagance, mismanagement and perhaps even downright fraud. — ED.

II

THE DEVELOPMENT OF THE WHISKEY TRUST[1]

IT is probably too soon to tell with even a reasonable degree of certainty what the outcome of the present tendency towards combination among producers is to be. So far there have been not a few egregious failures, the most noteworthy being the collapse of the copper syndicate — though that was hardly a trust, technically speaking; but there have been also a few apparently noteworthy successes. It seems clear, at any rate, that we have still some time to wait before we can say what the resulting normal is to be; and in the meantime it seems best not to be too hasty in exterminatory legislation, in sweeping denunciation nor in unqualified praise, but to study as accurately as is possible the history, management and tendency of the individual organizations, that when the time for action comes we may act with knowledge. The present article is an attempt to describe, as accurately and fully as the information that can be secured will permit, one of the (apparently, at least) most successful of these organizations: "The Whiskey Trust"; more accurately: "The Distillers' and Cattle-Feeders' Trust." The significance and tendency of such an organization as this cannot be understood without a knowledge of the circumstances leading to its formation. In this case, interest is added by the fact that legislation by the United States and by some European nations is, doubtless, indirectly responsible in good part for the condition of business that led to the formation of the trust.

It is well known that, from the establishment of our government till the outbreak of the Civil war, distilled spirits were for the most part comparatively free from taxation by the United States. The tax levied by the recommendation of Alexander

[1] Abridged from the *Political Science Quarterly*, Vol. IV, 1889, pp. 296–319.

Hamilton, which led to the Whiskey insurrection in Western Pennsylvania, was comparatively very light (only 9 to 11 cents per proof gallon, as compared with 90 cents at present), and even this was repealed soon after the accession of Jefferson to the presidency. From that time, with the exception of four years (from 1813, when an increase of revenue was necessary to carry on the war, till 1817), spirits were free until the outbreak of the Rebellion. As a consequence, they were sold at a very low price, — 24 cents on the average in New York for the five years preceding 1862, with a minimum price of 14 cents per proof gallon, — and there was little temptation to overproduction for either the home or foreign market.

At the outbreak of the Rebellion the necessity for increased revenue that led to the imposition of internal taxes wherever it was thought that a revenue could be raised, "without much regard to acknowledged politico-economic laws or precedents,"[1] resulted, of course very properly, in the taxation of distilled spirits. The first tax of 20 cents a proof gallon (July 1, 1862) was followed, March 7, 1864, by an act raising the tax to 60 cents per gallon. July 1 of the same year the rate went to \$1.50; and January 1, 1865, to \$2.00 per gallon.

At each increase of the tax, considerable time intervened before the highest rate was imposed. As a natural consequence, distilleries were run to their utmost capacity, and even new distilleries were built to get a stock on hand.[2] As Mr. H. B. Miller, the president of the whiskey pools, writes:

> Some time intervened before the various amounts were collected, and during this time the distiller and speculator had nearly the whole benefit of the tax without paying it. The speculation in whiskey during this time was tremendous. Editors, ministers, statesmen, — all took a hand. Distilleries were erected all over the country, and at the end of the war there was three times the capacity that could be utilized.

[1] Reports of United States Revenue Commission, 1865–66, p. 2.

[2] *Ibid.* p. 6: "Thus, for example, the commission estimate that on the 1st of July, 1864, the date when the advance in the tax on distilled spirits of from 60 cents to \$1.50 per gallon took effect, there *were made and stored*, in anticipation of this advance, at least forty millions of gallons, or a quantity sufficient to supply the wants of the country for at least a year in advance."

To the same effect David A. Wells, in the article on "Distilled Spirits" in Lalor's *Cyclopedia of Political Science*, writes:

> The immediate effect of the enactment of the first three and successive rates of excise was to cause an almost entire suspension of the business of distilling, which was resumed again with great activity as soon as an advance in the rate of tax in each instance became probable. The stock of whiskey and high wines accumulated in the country under this course of procedure was without precedent; and Congress, by its refusal to make the advance in taxation, in any instance, retroactive, virtually legislated for the benefit of distillers and speculators rather than for the treasury and the government. The profits realized by the holders of stocks, thus made in anticipation of the advance in taxation, has probably no parallel in the history of any similar speculation or commercial transactions in this country, and cannot be estimated at less than $50,000,000.

When the period of speculation was over, the great amount of surplus capacity for manufacture and the large amounts of stored products on hand made it, of course, almost or quite impossible for distillers who did not practise frauds on the revenue to continue in business. The high taxes, however, led to such frauds that whiskey often sold in the market for less than the amount of the tax.

Another factor that contributed to the general depression was the lessened demand for alcohol for use in the arts and manufacture. With alcohol at 30 or 40 cents a gallon, it was used in large quantities for the manufacture of burning fluid, varnishes, furniture polish, perfumeries, patent medicines, even as fuel for cooking, etc.; the United States revenue commission estimating that in 1860 not less than 25,000,000 gallons of proof spirits were so used. When the tax was $1.50 and $2.00, or even 50 cents, as it was from 1868 to 1872, spirits, of course, became too expensive for such purposes. As the tax has been still higher since that date (70 cents till 1875, and 90 cents since that time), no increased demand for such purposes has been felt.

These causes, including the large amounts fraudulently manufactured in the earlier years of the high taxes, had tended to

keep the distilling business in a comparatively depressed condition after the speculative period following the war had passed. Even as early as 1870 or 1871 the distillers felt themselves compelled to enter into an agreement to limit their distilleries to two-fifths production; and all north of the Ohio, with two or three exceptions, made such an agreement. No very decisive effect, however, was produced by this arrangement. The facilities for manufacturing adapted themselves gradually to the demand; and, on account of our cheap grain, a fair export trade was growing up that relieved the situation somewhat. But in the years from 1878 to 1882, on account of successive crop failures in Europe, a very heavy export demand at paying prices sprang up. In 1879, 1880, and 1881, nearly 16,000,000 gallons a year were exported.

TABLE I

SPIRITS REMOVED IN BOND FOR EXPORT[1]

Year	Taxable (proof) gallons exported	Percentage of production	Year	Taxable (proof) gallons exported	Percentage of production
1873 . . .	2,358,630	3 45+	1881 . .	15,921,482	13 52+
1874 . . .	4,060,160	5.90+	1882 . . .	8,092,725	7 64+
1875 . . .	587,413	0.96+	1883 . . .	5,326,427	7.19+
1876 . . .	1,308,900	2.25+	1884 . . .	9,586,738	12.70+
1877 . . .	2,529,528	4 22+	1885 . . .	10,671,118	14.24+
1878 . . .	5,499,252	9.80+	1886 . . .	5,646,656	7.02+
1879 . . .	14,837,581	20 63+	1887 . . .	2,223,913	2.85+
1880 . . .	16,765,666	18.55+	1888 . . .	1,514,205	2.15+

To meet this demand many new distilleries, including some of the largest in the country, were built, while the old ones, of course, were run at full capacity. After 1880, good crops in Europe, poor crops at home, with some changes in the tariff laws[2] of leading European countries, especially discriminating duties against the United States, cut off this demand, and left

[1] Report of the Commissioner of Internal Revenue, 1888.

[2] René Stourm, L'Impot sur l'alcool dans les principaux pays, p. 48.

the distilleries of this country with a capacity sufficient to produce four times what the home market needed.[1]

Of course, there was, at first, great over-production, and consequent distress among distillers. They could not export except at a loss; their cattle were in the barns (the feeding of cattle on the slop from the distilleries is one important adjunct to the distilling business), so that it was difficult to close the distilleries; their warehouses were filled with goods, and the market was broken. Something must be done.

> Some said: Let this go on and let the fittest survive. Our experience was that a distiller would keep on until all his own money and all he could borrow was gone, and when he was used up there was another man ready to step in his shoes.[2]

In November, 1881, a general meeting was called to form a pool. Prices were really below the cost of manufacture in many places, and the only remedy seemed to be to limit the output, and to export the surplus, even at losing prices. The "Western Export Association" was formed, the officers of which were authorized to levy a monthly assessment on each distiller running his distillery. This assessment was to be proportionate to the amount of grain used in manufacture, and high enough to pay the losses arising from the exportation of a quantity of spirits sufficient to relieve the home market.

An appeal was made to Congress, asking that an export bounty be given equal to that granted by Germany; or, if a bounty for export should not be given for fear of lessening the revenue, that the internal revenue tax be raised to $1.00 and then a bounty of 10 cents for export be granted. Congress and

[1] In the references to the trade, especially the exports, all the manufacturers of whiskey have so far been considered. As the whiskey pools have mostly concerned only one branch of the business, and as the trust is limited to this branch, *i.e.* the manufacturers of a product for immediate use, it is worth while to call attention to the distinction. One class of producers, especially those in Kentucky, manufacture "Kentucky whiskey," technically so called, *i.e.* a product that needs to be stored for some time (from two to five or more years) before it is in good condition for use (J. M. Atherton: Testimony before Committee on Manufacture, p. 3); the other class of distillers, located mostly north of the Ohio river, manufacture alcohol, pure neutral or cologne spirits, etc., a product that is fit for immediate use.

[2] Letter from H. B. Miller, former president of the pool.

the people, however, had not forgotten the whiskey-ring scandal, and consequently Congress did not dare legislate in favor of distillers, even if such legislation should injure no one.

This first pool lasted till May, 1882; then, some members refusing to pay their assessments, it broke up. The distillers had been able to keep prices somewhat higher by its means; but after the breaking of the pool, they ran at low profits, many of them at a loss, or else shut down during the summer—a proceeding which in itself involved of course a decided loss. In September, 1882, they organized again for one year on a similar plan; but it was found necessary to make an attempt to limit the output of the distilleries to a small percentage of their capacity, in addition to the relief of the market by exporting.

It soon became evident that it was cheaper to limit production by paying some distilleries to suspend production entirely, permitting the others to work at more nearly their full capacity, than to limit all to a fixed percentage of their normal production.

Though the Kentucky product is of a different kind from that manufactured by members of the pool, it of course came into competition with the latter when it had aged enough to be put upon the market. The law allowing distillers to keep their product in bond for three years before paying the tax had led to a heavy overstocking in Kentucky, and when this stored product first began to come upon the market, the situation became still more trying.

From 1883 till 1887 the pool continued for a year at a time, with a suspension as often as once each year. Sometimes the better plan seemed to be to limit the output of the distilleries, leaving each distiller to attend to the marketing of the product himself; sometimes for the officers of the pool themselves to provide for the export of any surplus, assessing the individual distillers the amount required to pay any loss on the export. In the articles of organization of the pool of 1884, we read:

Only 28 per cent of the full capacity shall be operated, and no stocking up beyond this amount allowed under any circumstances. Any member operating his house and producing any kind of distilled spirits

must take care of them himself. The association is debarred from paying any member for maintaining any market, exporting goods, or warehouseing them.

In spite of the small percentage of capacity run during this year, the pool suspended in the spring of 1885, though it reorganized again in October of the same year. At the organization of this pool (in 1885) a committee reported:

It is the sense of this committee that no distillery shall be allowed to run beyond 40 per cent. The basis for market price should be fixed at the lowest possible figure, it being recognized by all that high prices are detrimental and difficult to maintain.

Section 12 of their articles of agreement, differing from those of the preceding year, provides for exportation as follows:

To maintain prices at all times, the officers shall cause to be exported at any time without the United States any surplus that may at any time appear, allowing and paying therefor [such] a bonus as will equal the quotation prices, and [shall] report all such exports, the quantity shipped, the bonus paid, etc.

Section 13 further provided that the president should cause a suspension of the association for the following causes:

If a distiller runs more than he is entitled to run; if a distiller refuses to exhibit his government book to an authorized agent; if a distiller refuses or neglects to make his monthly report or refuses to accept his draft or pay his monthly assessments; if a distiller resumes his capacity and operates his distillery having once sold it; in case exported goods are re-imported and placed upon the domestic market; in case closed houses are not paid in full, and in one payment, for each month, before the close of said month.

A resolution was also passed providing that the association be suspended when any new distillery should be built and start to run. Provisions were also made for the examination of the government books of each distiller by the officers of the pool, in order to prevent deception and cutting of rates on the part of any distiller; but in spite of these precautions, and in spite of the high prices they were able to maintain for their goods in the pool, it was found that the temptations to secure sales by

the cutting of prices were so great that members would violate the terms of the agreement. Within two months after its formation, in calling a meeting of the distillers whose houses were running, in order to determine the amount of assessments, prices of goods, etc., the president of the pool expresses clearly the state of the trade. It should be remembered, in considering his words, that they were written not to influence legislation or public opinion, but that they were addressed to men directly concerned, who knew the circumstances. Among other things, he says with reference to over-production and the proper policy of the pool:

That we shall over-produce after the holidays we all know—we knew it when we organized in Chicago and for that very reason made the assessment 12 cents on 40 per cent to create an export fund.[1] That we have already over-produced, figures will show. . . . A few more days running without a pool would have wound you up, and this over-production we are not trying to get rid of by exportation. You want to look these figures square in the face; and if it takes more money to do our exporting than you thought, it is occasioned by your own folly in over-producing so heavily in September and October. As long as we have funds to export the surplus there will be no difficulty in maintaining prices. When goods accumulate without any outlet, then is the time when cutting commences . . . It will not do to make the price of goods too high, for as we raise the price we must raise the bonus on exports correspondingly. . . . There are but two things left for us to do; either provide sufficient means to keep our warehouses clear of the surplus by exportation, or let the market go to pieces of its own weight. I am well convinced there is cutting going on secretly now, and unless provision is made at once to arrest it, it will be done openly, until there is nothing left of the market. Situated as we are, the question is no longer as to making a great amount of money, but to prevent our suffering great losses. This is the problem for you to solve, and the meeting is called thus early as an imperative necessity, and all running houses should be present. Distillers, when they have an accumulation of goods on hand, will not hesitate to cut prices *one cent* a gallon to make a sale, when they will hesitate to pay one-half cent a gallon to make cutting *unnecessary*, even if double the amount is placed in their hands. Right

[1] That is to say, 12 cents for each bushel of capacity run, when the houses were running at 40 per cent of their full capacity. The capacity of a distillery is measured by the number of bushels of grain consumed per day.

here I will repeat what I have so often stated before, that the amount of the assessment does not come out of the distiller, but out of the consumer, the same as the government tax, and he [the distiller] is merely the agent to collect and pay it over, of course with the qualification that prices are maintained.

He closes a series of statistics (regarding the output in competing states) with the words:

I have been particular in giving you all the information possible, so you can act intelligently at the next meeting. The only way to maintain prices is to get rid of the surplus by exportation. You can fly in the face of Providence if you see fit, but it will bring its own punishment with it.

TABLE II

POOL ASSESSMENTS, SEPTEMBER, 1884, TO APRIL, 1887, INCLUSIVE

	1884 Cents per bushel mashed	1885 Cents per bushel mashed	1886 Cents per bushel mashed	1887 Cents per gallon
January		8	16	3
February		8	9	3
March		8	10	4
April		8	10 (Extra assessment for 1 day 35 cents)	4
May		7	10	
June		9	8	
July		9	4	
August		9	6	
September[1]	6		{ per bush. 2 per gal. 2	
October	6		per gal. 3	
November	8	12	" 3	
December	8	12 (Also extra assessment for 1 day: $1 50 per bushel.)	" 3	

[1] Assessment for September, 1886, was 2 cents per gallon produced (equal to 9 cents per bushel), and also an assessment of 2 cents per bushel; making a total of 11 cents per bushel. By multiplying the assessment per gallon by $4\frac{1}{2}$, the amount per bushel will be obtained nearly. About $4\frac{1}{2}$ gallons of spirits are made per bushel corn.

A pool seemed a necessity; but the experience of this and of the following year seemed to show that a pool could not be maintained. The competition, there can be no doubt, was for many ruinous, though those best situated could live and make profits. The difficulty in maintaining the pool, together with the effect of the pool on prices, may be seen in the fluctuating figures of Table III (page 37). The same movements are illustrated graphically in the Diagram (pages 42, 43), and there the changes may be more readily noted. Table II shows the extent of the assessments from September, 1884, to the time of the formation of the trust. It has not been possible to obtain the earlier assessments.

In consequence of the competition, and in order that a closer organization might be established, it was determined by the leading distillers, in the spring of 1887, to organize a trust, formed upon the model of the Standard Oil Trust. The "trust agreement," published in the examination of the president of the trust before the congressional committee in 1888, provides that the trust created shall be vested in nine trustees; that these trustees, under bonds of $100,000 each, shall, in accordance with section 11:

. . . exercise supervision, so far as their ownership of stocks enables them to do, over the several corporations or associations whose stock is held by said trustees. As stockholders of said corporations they shall elect or endeavor to elect honest and competent men as directors and officers thereof, who shall be paid a reasonable compensation for their services. They may elect themselves as such directors and officers, and shall endeavor to secure such judicious and efficient management of such corporations as shall be most conducive to the interests of the holders of trust certificates.

No distillery was to be allowed to join this trust except the members of the former pool; but any member of the former pool, if a corporation, might join upon the assignment of a majority of stock by the individual stockholders to these trustees. For the stock thus assigned, the trustees prepared stock certificates, which showed the interests of each beneficiary in said trust. The certificates were divided into shares of the par

value of $100 each, and were known as the "Distillers' and Cattle-feeders' Trust certificates." Any distillery not owned by a corporation might be re-organized in corporate form in order, by the aforesaid assignment of stock, to join the trust. In accordance with section 4 of the trust agreement, no certificates could be issued except for stock, and the par value of the certificates issued were to represent as nearly as possible the actual cash value of the stock held by the trustees in trust. In estimating the value of the plants owned by the different corporations, the following elements were considered: (1) the cost of the construction of the plant; (2) the amount of working capital required for its management, and (3) its earning power. This last element, of course, depends upon various factors, and of necessity was left largely to the judgment of the committee appointed. The location of the distillery, the skill of its former managers, their ability to secure a sale for their product, and other factors would all need to be considered. Furthermore, the earning capacity of the distillery under the management of the trustees, if it should be allowed to run, might vary quite materially from its former earning power. These different considerations led the committee to issue certificates for from two to three times the cash value of the plants. This has led some of the critics to state that the trust certificates were about two-thirds water. A careful consideration of the factors involved will enable the reader to judge how far this is true.[1] That jealousy among the different corporations might be avoided, the value placed upon the stock of each corporation was not made known except to the corporation immediately interested and to the trustees.

The trust was to continue for twenty-five years from the date of its organization, and thereafter until terminated by a vote of sixty-six and two-thirds per cent in value of the holders of certificates, at a meeting called for that purpose.

At the first annual election three trustees were to be elected to hold their office for one year; three to hold their office for two years, and three for three years. Thereafter three trustees were to be elected annually to take the place of those retiring, each to hold his office for three years, except in case of those

[1] See Testimony of J. B. Greenhut before Committee of Manufactures, pp. 73 *et seq.*

elected to fill a vacancy, who should hold until the expiration of the term. A person to hold the office of trustee must be the actual owner of at least 500 shares of trust certificates.

The meetings of the certificate holders take place annually, and may be called oftener at the request of thirty-three and one-third per cent of value of the trust certificates.

It is to be noted that this trust agreement expressly provides that the trustees are not limited in their duties, as has been often suggested, to the receipt of dividends or interests upon the stocks or moneys held in trust, and to the division of such dividends to the holders of trust certificates; but they are also to elect competent men as directors and officers of said corporations represented, and are to exercise supervision over the several corporations whose stock is held by them as trustees. Furthermore, it is to be noted that these trustees in every case hold a majority of the stock in each corporation, so that their control over each distillery is absolute. A manager is appointed by the trustees for each distillery, whose salary is paid out of the trust funds. This manager is, of course, usually one of the leading original stockholders and managers in that distillery.

In order that the business may be kept well in hand, reports are required daily from each distillery engaged in manufacture; and each distillery that is running sends in a detailed report every month, showing the exact cost of manufacture of the product and all other details regarding the management of the business. Again, by these monthly reports the trustees are able, if they wish to lessen or to increase the amount produced, to close the distilleries that are working least successfully or to open those that furnish the best opportunity to supply any special market. The trustees are also at liberty to purchase distilleries that are running outside of the trust, and to lease distilleries managed by the trust, whenever in their opinion this plan seems more profitable than to operate them by trust officers. In the latter case, of course, the profits are still held under the control of the trust.

This firm control over the different distilleries enables the trustees to control the market by limiting the output of the product to the amount demanded rather than by exporting

the surplus at a loss, as was done under the old pools. Almost no attempt has been made by the trust to gain control of the foreign market, and none of the product has been exported at a loss since the formation of the trust. Their comparatively small exports (see Table I, page 25) have been at paying prices. A brief examination of Table II (page 30), which gives the monthly assessments levied upon the members of the old pool (from 6 cents to 18 cents per bushel) from September, 1884, to the formation of the trust in May, 1887, will show how great a saving has thus been effected.

Another saving is that which comes from the lessened expenses of management, resulting from the closing of so many distilleries. Nearly all the distilleries in the former pool, to the number of more than eighty, have become members of the trust. In order to limit the output to the demands of the market, these distilleries, if running when they joined, have been from time to time closed, until at the present time twelve distilleries supply the total amount that is placed by the trust upon the market. One or two others are running, but for the production of yeast, or some other product than spirits. It is by no means to be assumed that the decrease in the output corresponds in any manner with the number of distilleries closed. When it is taken into consideration that for several years the output of the distilleries had been often limited to from 25 to 50 per cent of their capacity, many of them even closing for portions of the year, it will be seen that an equal output might be produced by a much less number of distilleries. That there has been a smaller aggregate output is doubtless true, and that to an extent more than enough to balance the lessened amount exported. The amount is held in hand well enough, so that the trust can manage to control the market.

An examination of Table III (page 37), which gives the market prices of corn and whiskey from the time of the formation of the first pool, in 1881, to March, 1889, will show that the price of alcohol has not been to any noticeable extent raised by this closing of the distilleries. For some six or eight months after the formation of the trust the prices were lowered eight or nine cents per gallon, although the prices of corn ruled somewhat higher

than before. Presumably the purpose of this lowering of the prices at first was to bring pressure to bear upon the distilleries yet remaining outside of the trust in order to force them to join the trust, or else because in the beginning the trust did not yet have strength to force the market. After all or nearly all of the members of the former pool had joined the trust, so that its membership was practically complete, and it became evident that a contest with the distillers yet remaining outside was at hand, the managers of the trust raised the price. The new members would need dividends to keep them contented, and there was also a necessity of accumulating a fund upon which to enter upon this contest with their rivals.

A comparison of the prices of corn and alcohol for the year preceding the formation of the trust with the prices from May, 1888, to January, 1889 (see Table III, or Diagram), will show that the profits made by the trust have not been greater than those made by the old pool, unless the cost of management of the distilleries has been much decreased; and yet, during this period from May, 1888, to January, 1889, the trust had put the price high enough to enable them to pay good dividends to members that might otherwise have become dissatisfied and to accumulate a surplus for the purpose of a contest with outsiders. It is from this very evident that the saving in cost of management and manufacture has been very great. It must also be kept in mind that from twelve to twenty distilleries have been earning these dividends on stock that represents some eighty-three distilleries. This emphasizes still more the great saving effected in expenses.

The immediate result of this increase in price (from $1.05 to $1.09 per gallon, and then to $1.14) was the building of new distilleries, notably the large distillery at St. Paul; the opening of many small distilleries, and the manufacture of spirits by the smaller distilleries in Kentucky, whose normal product was whiskey for aging. When at length it became evident that the distilleries outside of the trust were also making a large product and the output from these distilleries was beginning to have its effect upon the market, the trustees, on the 1st day of January, 1889, again cut the price of the product to $1.04 per gallon, in

order to crush their opponents. The smaller distilleries in Kentucky and elsewhere of course closed promptly, or changed the character of their product. The most formidable rivals of the trust, Shufeldt & Co. of Chicago, who had doubtless also made large gains from the increase in price and who had run their distillery at even more than its normal capacity, at once cut down their output, though they have not closed and are even building a new house of 3000 bushels capacity.

What the next move will be, remains to be seen. It is said by the managers of the trust that their best policy is to hold the price of the product below the cost of manufacture by most of the rival distilleries and thus keep the market steady. They claim that they are able to do this from the saving in management and from the fact that they run only the distilleries most favorably located. For local trade they can run those that will save freight; and, in fact, they run one in Cincinnati, one in St. Louis, one in Kansas City, etc. The figures of the trust, gathered from the various distilleries under their control, show that the distilleries at Peoria have an advantage of from 14 to 15 per cent over most of the distilleries located elsewhere, so that here some six are running. It is the belief of distillers not members of the trust, as well as of the trustees, that a Peoria distillery has at least 10 per cent advantage over a distillery located at Chicago, and nearly 20 per cent over one located at St. Paul. This claim seems to be substantiated by the statement of Charles Clark, for many years past a prominent distiller at Peoria, though not now in the business himself. He says that at times of great depression in the business, during the existence of the former pools and earlier, his distillery made regularly 10 per cent on the running capital and 25 per cent on the plant, besides good salaries for the managing members of the firm. With the exception of one year this rate of profit was made for many years prior to the formation of the trust, and in that unfortunate year there was a clear profit of $12,000. During this very time the complaints of distillers in other parts of the country that money was being lost and that no interest could be made on their investments were doubtless often true. On the other hand, in estimating the ability of the trust to com-

TABLE III

MARKET PRICES AT PEORIA FOR WHISKEY AND CORN FROM 1881 TO 1888 INCLUSIVE

MONTH	1881		1882		1883		1884	
	Whiskey	Corn	Whiskey	Corn	Whiskey	Corn	Whiskey	Corn
January			1.15-1.16	62-59	1 13-1 14	44½-50½	1.15-1 16	41½-47
February			1 16-1.17	58½-54	1 14-1 15	48-55½	1.16-1 17	47-42
March			1 16	58¾-66½	1 15	56¼-49	1.17	41½-48
April			1 17	66¾-75½	1 15	47½-52½	1.17-1 12	43½-50½
May			1 13-1.17	75-70½	1.15	50-53	1.12	48-54½
June			1 11-1 15	72-69¼	1 15	53-47½	1.08	50-45½
July			1 11-1.14	73-75½	1 15	48-45	1 08-1.07	44-49
August			1.14-1 16	74½-77	1.15	45-51	1 05	47½-50½
September			1.16-1.18	75-59½	1.15	49½-46	1 10-1 11	51-45
October			1.16-1.18	61-70¼	1 15	45-47¾	1.11	40-53
November	1 11-1.15	62½-58	1.14-1.15	70½-67	1 15	46½-49	1 11-1 12	42-30
December	1 15	58½-62	1 13-1.15	55½-45	1 15	52-45	1.12	30½-35

MONTH	1885		1886		1887		1888		1888	
	Whiskey	Corn	Whiskey	Corn	Whiskey	Corn	Whiskey	Corn	Whiskey	Corn
January	1.12-1.14	34½-40	1 10	33-35	1.14	33¾-35½	1.09	48¼-47	1 04	30
February	1 14	38½-36½	1 10	34-32¾	1.14	35¼-33¾	1 09	47-45¼	1 04	29½
March	1 14	37¼-40½	1 10	33-34¼	1 14	33¾-38	1 09	45¾-49	1.04	30
April	1.14	39¾-47½	1.10	33¾-32½	1.14	37¼-36	1 09	47¼-53¼		
May	1 14	50-45	1.10	33-29½	1 14-1 05	37-38½	1 09-1.13	52½-57½		
June	1 14	44-47½	1 10	29-31	1 05-1.09	38¾-36	1 13-1.14	53¼-46½		
July	1 14	47-43¾	1 10-1.07	28¼-41½	1.05	38¼-34¼	1.14	49-43½		
August	1 14	45¼-42½	1.09-1.11	40½-39	1 05	38¾-42¼	1.14	45¾-40		
September	1.05	43½-40½	1.11-1.13	38¾-36	1.05	41½-39¼	1.14	44-40½		
October	1.04-1.09	42½-38½	1.13-1.14	35½-32½	1.05	39½-41¾	1.14	39¼-44		
November	1 09	44½-32	1.14	33¾-36½	1 05	39½-46	1.14	42½-38		
December	1 09-1.10	33½-31½	1.14	35½-33½	1.05	44¾-49½	1.14	33½-29½		

AVERAGE YIELD PER BUSHEL[1]

YEAR	YIELD	YEAR	YIELD	YEAR	YIELD	YEAR	YIELD
1881	3.694	1883	3 874	1885	4 076	1887	4 62
1882	3.792	1884	3 895	1886	4.55	1888	4.53½

[1] The average yield for the last three years is for the Trust or Peoria distilleries. The government report, including all distilleries, gives for the years 1886, '87, '88, respectively, the yield 4.09+, 4.23+, 4.24+.

pete with its rivals, it must be remembered that fourteen distilleries must make profit enough to pay dividends on the capital invested in more than eighty distilleries, a drawback amply sufficient to offset any slight benefit in the cost of manufacture. A distiller who has no closed houses to carry, no dividends to pay on capital that is inactive, has certainly something of an advantage. If the trust holds its own firmly, however, this advantage will soon to a great extent disappear, as the trust will doubtless, as opportunity offers, dispose of the useless closed distilleries and turn the dead capital into profitable channels.

The trust has, doubtless, had some benefit from the fact that dealers would fear to incur the hostility of so powerful an organization by purchasing from its rivals. This is again offset in part, by the popularity of certain brands of whiskey (though this would apply especially to the Kentucky product) the manufacturer of which can always be sure of his market. It is probable, at any rate, that the advantage is not so decidedly with the trust that it can totally crush out all competition, though this can be determined more certainly after a year or two. At present it manufactures only from 80 to 85 per cent of the total product in the market, and its rivals are preparing to compete still more vigorously. Shufeldt & Co. of Chicago, as has been said, are building a new distillery, and there are reports that others in Illinois are soon to be built. The trust cannot afford to buy out all distilleries that may be built. If it is to succeed, it must keep its prices so low that new distilleries will not be built. Its action in pushing up the price last year, if a merely temporary expedient to accumulate a fund, was perhaps a wise move from the standpoint of the trust; but such prices, quoted too often, would not be of advantage. The trust must succeed by underselling its rivals, not by buying them out. This is evidently, too, the policy of the organization; for it is a rule that no distilling company not in the old pool can join the trust. Even those companies have not been coaxed in by too large offers, as is sometimes asserted. The assertion made in the New York *Evening Post* of January 2, 1889, by the agent of Shufeldt & Co., that the trust had tried in many ways to force that firm into union, and had even offered it $1,000,000 in

cash to join the organization is, even if correctly reported, not true. Both the trust officers and Shufeldt & Co. deny it. Doubtless the trust would be glad to be joined by so important a rival; and it is conceded by members of the trust that, had the company joined them when the trust was organized, its managers could have had much influence in the new organization. The implication is that they might have had a trustee. It is worth while to give this much of the case, because it shows the position the trust has taken regarding perhaps its most formidable rival, and the course it must pursue if it is to succeed. It must meet its competitors in fair business rivalry and be able to control by low prices the larger part of the sales.

As much is said regarding the influence of trusts and combinations of all kinds on wages and prices of materials, it may be worth while to mention the statements on this subject furnished by the president of the trust to the congressional committee. The coopers that manufacture barrels for the distilleries and the miners that furnish coal both testify that the distilleries connected with the trust voluntarily raised the prices for barrels and coal so that fair wages could be paid. Before the organization of the trust such a rise in prices could not be given on account of the fierce competition, and even after its formation distilleries not connected with the trust held the miners to their former oppressively low contracts, instead of following the example of the trust. The president of the trust adds that while they "do not wish to take the position as posing before the public as benefactors to any extent," yet they do believe in "the principle of intelligent cooperation," and as they can afford to pay good wages they are willing in justice and fairness so to do.

Most of the advocates of trusts and pools claim that one of the chief advantages to come from them is *stability* of prices. An examination of Table III, or better, of the Diagram, will show that while the fluctuations are somewhat less frequent under such a régime, yet, when a fall or rise in price does come, it is sudden, and is apt to be a change of considerable extent. It is very questionable if there is any gain from such a policy. The lack of stability under the old pool was due, it was claimed,

to the instability of the pool itself; but so far matters have been little better in this respect under the trust. One thing seems better under the trust: the trust itself has stability, and seems to have power; it may steady prices if it will put them somewhat low and be satisfied with moderate steady returns, instead of striving for great gains interspersed with very small ones. The future will determine what is to be its policy. The managers of the trust say that the policy of the trust is to secure steady, moderate gains; others who are interested question this. The system of high gains alternating with low ones, if pursued as a regular policy, would do much to justify the distrust of the public and would take away the only ground on which such combinations can fairly be justified: low, steady prices.

A sufficiently accurate estimate of the real benefits accruing to the various distilleries from their association in the trust may be obtained from an examination of the dividends paid by the trust since its formation, and from the value of the trust certificates. Although the trust was organized in June, 1887, many of the distillers belonging to the old pool had not been received into the trust until about the beginning of the following year; so that any dividends paid before January, 1888, cannot be considered fair tests of the management or of the success of the trust. From January, 1888, to July, 1888, inclusive, a dividend of one-half of one per cent per month was paid; for August the dividend decreased to one-fourth of one per cent; and from September till January, 1889, inclusive, dividends of one-third of one per cent per month were declared. The dividend for February, 1889, again decreased to one-fourth of one per cent, owing doubtless to the late cut in price. It must be borne in mind, also, that in addition to the dividends throughout the year 1888, a surplus was being accumulated to carry on the contest with outside distillers. It was said by some members of the trust, when the trust certificates were valued at 30, that they then represented about the actual cash value of the plant. If this be accepted as an accurate estimate, and it is doubtless not far from the truth, we can readily see that the trust has paid dividends, during somewhat more than one year of active existence, of more than 12 per cent per annum.

TABLE IV

QUOTATIONS OF MARKET VALUE OF DISTILLERS' AND CATTLE-FEEDERS' TRUST CERTIFICATES

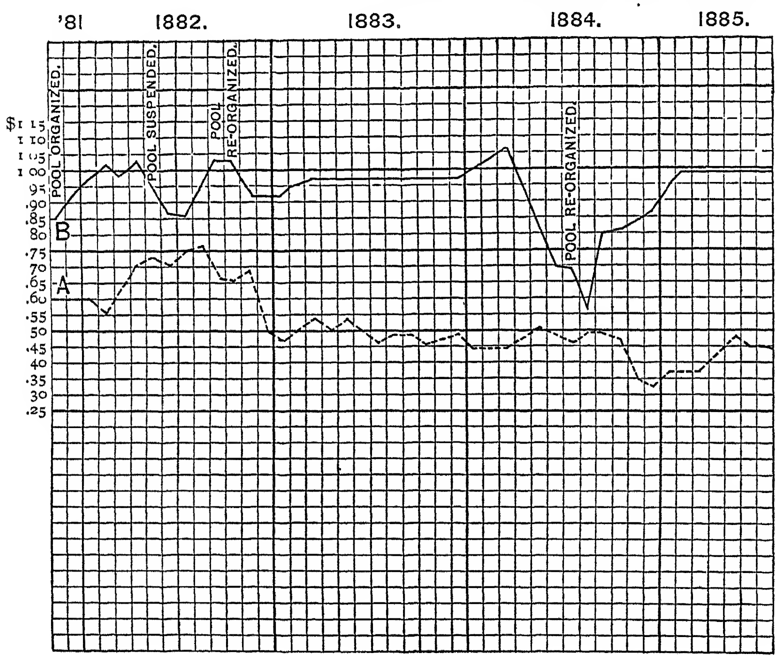
1888.	March	1.	50.	1888.	Aug.	28.	43.	1889.	Jan.	15.	30.
		14.	48.		Sept.	7.	40.			31.	31.
	April	1.	45½.			19.	39½.		Feb.	9.	32.
		20.	42½.		Oct.	10.	36½.			18.	33.
	May	11.	45½.			20.	35½.		March	4.	34.
	June	4.	43.		Nov.	13.	39.			7.	35.
		18.	40.			21.	39.			13.	36½.
	July	2.	41.		Dec.	12.	35.			20.	35½.
		7.	44.			21.	33.		April	1.	34.
		24.	45.	1889.	Jan.	4.	33.			6.	34.
	Aug.	13.	42.								

An examination of Table IV, which gives the value of trust certificates for each month from March, 1888, to the present time, will lead us to about the same conclusion. As soon as it became evident that the trust was firmly established and bade fair to be a success, some small sales of certificates were made to enthusiastic buyers as high as 65; others among distillers at 55; but no real market for trust certificates was established above 50. With some slight variations the value has slowly decreased, until in January, 1889, the lowest value (30) was reached, since which time a slight increase in value is to be noted. The figures in this table are based upon actual sales, and there can be no doubt as to their accuracy. It is, however, to be remarked that the certificates are held mainly by the large distillers as investments (though the number of individual certificate holders has largely increased), and that comparatively few transfers of trust certificates have been made. The prices quoted of course depend, too, to some extent, upon the amount invested at the time. The certificates are not listed in any stock exchange, and there cannot be said to be any regular market for them, though they can be obtained through brokers in four of the principal cities: Peoria, Chicago, Cincinnati and New York. The figures given represent, then, almost with perfect accuracy, the value placed by the distillers and the liquor dealers upon the certificates.

The facts given with reference to the working of the trust

seem to show that it has been beneficial to the greater portion of the manufacturers of alcohol and spirits in the United States, although individual distillers have perhaps made no more, and some, it may be, have made even less profit than they could have made acting independently; while, so far at least, the prices to consumers have not been on the whole increased, and the tendency seems to be towards lower and steadier prices for the future. As has been said, however, only the future can

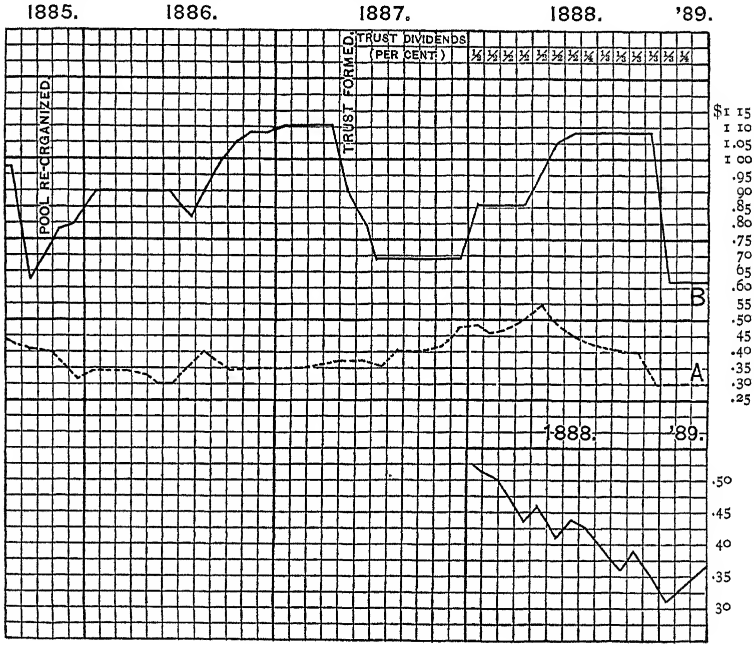
DIAGRAM ILLUSTRATING THE HISTORY



The (dotted) line A shows the average market value of corn per bushel at Peoria. The line B shows the average market value of the whiskey (the spirits used for base in prices) from one bushel of corn. To obtain this value, the revenue tax was deducted from the market value of one gallon, and the difference multiplied by the average yield per bushel of corn. — The space between the lines A and B represents, of course, the cost of production plus the profits During the greater part of the pool's existence, assessments for export expenses must be deducted from the profits. (See Table II.)

determine what the policy of the trust is to be. The facts seem to show that it is within the power of the trust to bring about this result; and it seems to be for its interest so to do. As regards the stronger rivals of the trust, the prices have so far been so high that they have not suffered materially. The next year or two will show whether they can endure the competition. Even if they should be forced to close, the question is still an open one whether more distilleries would have not been closed

OF THE WHISKEY POOLS AND TRUST.[1]



The line in the lower right-hand corner shows the fluctuations in the value of the trust certificates: par value, 100; cash value of plant estimated at about 30.

[1] Professor Jenks, in his *Trust Problem*, N.Y., 1902, p. 146, continues this price diagram to 1900. Much other information is in the Reports United States Industrial Commission, Vol I, 1900. — ED.

under free competition. Many stockholders are now drawing dividends from the trust who, without the trust, would doubtless have lost much of their capital.

At the time of the formation of the trust, it was thought by some of the distillers living at Peoria that, on account of their unusual facilities for manufacture, the trust should be limited to Peoria distilleries and a few others favorably located. The experience of the trust seems to show that, had this plan been followed, the trust might have paid higher dividends to its members and might also have held the price of alcohol so low that outside competition would not have been much more successful than it has been under the present arrangement. Some distillers who believed in this latter plan — presumably for the most part Peoria manufacturers — still think it would have been better to have limited the organization to five years with the option then to continue, suspend, or reorganize. They feel that the owners of the less favorably situated distilleries have an undue advantage. Of course, this depends mainly upon the relative value placed upon the plants when they entered; but it is probable that it would have been cheaper to crush some of the weaker members than to buy them by admitting them to draw dividends. Against this view is, of course, the fact that such action would have aroused bitter hostility that might well have resulted in the building of new distilleries in locations where they would have become formidable rivals.

On the whole, while there is this slight tendency to think that matters might have been better under some other form of organization, or even, for a few, with no organization; and while there may be a slight feeling that the trustees are not entirely free from nepotism in their appointments, any more than are our highly esteemed executive officers of the United States; yet; as was shown a year ago by the unanimous reëlection of all the trustees at a meeting in which ninety-nine and one-half per cent of all the certified holders were represented, as well as by the general expression of satisfaction on the part of the distillers one meets, the trustees are thought to have performed their responsible duties with descretion, and the trust is considered by its members a success.

J. W. Jenks.

The later history of this combination has been checkered. In 1890, it was reorganized as a corporation, as the Distilling and Cattle Feeding Co. Its ownership of distilleries was extended to practically all important competitors. In 1893, failure impending because of the accumulation of floating debts for unpaid rebates, bonds were issued. For two years various scandals, mainly speculative, developed under its control by receivers; and the Supreme Court of Illinois in 1896 ousted it from its franchises (156 Ill. 448). Meanwhile in 1895 it had been again reorganized as the American Spirits Manufacturing Co., incorporated in New York. This company took over all the best distilleries in the field. Other plants and branches of the business were independently incorporated under the laws of New Jersey during the next four years in three principal companies. These were again united to the main stem in 1899, as The Distilling Co. of America, capitalized at $125,000,000. Over ninety per cent of the securities of this company in 1902 were in turn acquired by a holding or finance company, the Distillers' Security Corporation of New Jersey, which has issued about $50,000,000 of capital stock. — Ed.

III

THE WIRE-NAIL ASSOCIATION OF 1895-96[1]

SO lately as 1888 *The American Architect* began an article on nails in this way: "The nails commonly used in connection with building operations are too well known to require any description. They are specifically designated as plate nails."[2] That year, 1888, was almost the first in which plate or cut nails felt a real competition from wire nails. In that year the latter formed less than a fifth of the total product;[3] in 1895 they constituted nearly three-fourths. The idea of making nails of wire did not arise in America; in fact, our people were even somewhat slow to adopt it. The first wire nails — headed by hand and ground to a point — appear to have been made in France early in this century.[4] Mr. M. Baackes, an old wire-nail manufacturer of Cleveland, says that the first machine for forming the heads was made in France about 1850.[5] According to Mr. John Hassall, who is still engaged in making wire-nail machinery in New York city, his father was active in making and running the first wire-nail machines used in this country, early in the fifties.[6] The business seems to have extended itself only modestly, for Mr. Baackes regards the factory which he helped to start at Covington, Ky., in 1875, as "the first mill for the manufacture of wire nails on this side of the Atlantic."[7] The production rose from 20,000 kegs in 1880, according to Mr. Baackes's estimate, to 125,000 in 1887; and the average price fell from $20.00 per keg in 1875 and

[1] From the *Political Science Quarterly*, Vol. XII, 1897, pp 246–272.

[2] *American Architect*, Aug 18, 1888, p. 73.

[3] Report of American Iron and Steel Association, 1889, p. 45.

[4] M. Baackes, in *Iron Age*, Jan. 2, 1896, p. 106.

[5] *Ibid.* [6] *Iron Age*, April 23, 1896, p. 997.

[7] M. Baackes, in *Iron Age*, Jan. 2, 1896, p. 106.

$10.00 in 1880 to $4.81 in 1887. At the end of 1887 a manufacturer wrote: "Wire nails are now quoted at less than actual cost, as results will in time demonstrate."[1] About the same time the *Iron Age*, the leading paper of the hardware trade, said editorially: "It is evident that the business is now greatly overdone."[2] The production increased, however, to more than 300,000 kegs in 1890, and to nearly 600,000 kegs in 1895; and the average price fell to $2.85 in 1890, according to the estimate of Mr. Baackes, and to $1 60 in 1894. At present, April 1, 1897, it is about $1.50. These facts show how recently and how rapidly the business has attained importance, and how fast the price of wire nails has fallen.

The profits of the early wire-nail men, as first comers in the field, were doubtless good; but the cost of production at that time must not be gauged by the later selling prices. At the outset their machinery was imperfect. Then, the first nails were of small sizes, for special purposes, such as use in cigar boxes, furniture, mouldings, and wagons; and small nails are relatively costly. It was not till 1886 that a list of regular or "penny" nails was published, and a serious effort was made to compete with cut nails in the general market. The wire of the first makers, too, was all of Norway iron; for they could not get any other material on which they could form a head that would not break off in driving. The H. P. Nail Co., established in 1879, is said to have been the first to succeed in using Bessemer steel wire. Finally, the price of Bessemer steel itself was at first much higher than now. Although quotations on steel billets earlier than 1887 are not available, their fall in price may be gauged by that of steel rails, which dropped from an average of $48.25 per ton in 1879 and $67.50 in 1880 to $37.08 in 1887 Billets were $32.55 on the average in 1887 and $16.58 in 1894,[3] while they are now quoted at about $15.00. It was the removal of these early limitations that made possible the great expansion of the industry.

As the business is now carried on, regular nails are sold with reference to a "base price" and a uniform schedule, or "card,"

[1] *Iron Age*, Jan. 5, 1888, p. 22. [2] *Ibid.*

[3] Report of American Iron and Steel Association, 1896, p. 26.

of "extras." Excepting under the card made in 1895, the base has always been the same as the price of the largest nails. It is the base only that is named in market reports and in quotations. The extras, which are added to the base to determine the prices of the smaller sizes, are fixed by agreement of the manufacturers, and are likely to remain unchanged for several years together. From April 11, 1892, to July 19, 1895, the card was as follows:

60-d.	base (no extra)
50-d.	$.10 extra
30-d. and 40-d.	.25 "
20-d.	.35 "
12-d. " 16-d.	.45 "
10-d.	.50 "
8-d. " 9-d.	.60 "
6-d. " 7-d.	.75 "
4-d. " 5-d.	.90 "
3-d.	1.20 "
2-d.	1.60 "

When 60-d. nails were quoted at $ 85, put up in a keg which I am assured by a manufacturer cost at least $.09, the wire from which they were made was quoted at $1.15. Every nail-maker who bought his wire in the market lost the whole cost of handling and manufacture, and nearly four-tenths of a cent besides, on every pound of 60-d. nails he sold. The explanation of his apparent willingness to sell below cost is found in the character of the list of extras, and in the manner in which all orders were required to be assorted. The extras on all the smaller nails were far greater than the differences in cost between them and the largest. Indeed, the wire for a keg of 12-d. nails cost no more than that for a keg of 60-d. No manufacturer would sell 60-d. alone at the market price. All orders had to be so assorted that the average of the extras on the whole should be at least $.60 per keg: that is, if a dealer gave an order for a hundred kegs, at a base price of $.85, he had to make it up in such a way that the average price of the whole, by the schedule, would be not less than $1.45. So the loss on the larger and cheaper sizes was covered by the gain on the smaller and dearer. Some small manufacturers took advantage of this artificial ad-

justment of prices, by making only the smaller sizes, and leaving the losing end of the schedule to the great establishments.

I. History of the Association

Iron and steel products have been particularly fruitful of combinations; but before 1895 circumstances had not been favorable to bringing wire nails into the list. The manufacturers had been fairly contented, making the comfortable profits of a new and rapidly growing business. It is probable that combinations are not easily formed in any industry so long as the average man of those concerned, with average advantages, can make such a profit as the general opinion of business men pronounces fair; and that consolidation generally results from a strong sense of pressure. In this business, by the beginning of 1895, the necessary pressure had developed. The manufacturers cried out with one voice that they were ruined by competition. It must be noted, however, that most men do not consider it good policy, under any circumstances, to magnify their profits before the world; that men who have been accustomed to large profits do really imagine themselves ruined when they are reduced to not much more than ordinary interest on their capital; and that lugubrious statements, made in general terms and without figures, ought not to be taken without salt. The bulk of the wire-nail business was in the hands of six or eight great companies, which had their own wire mills and rod mills, and put the material through all the processes from the form of the steel billet. So long as smaller concerns, buying their wire in the market, continued to do business, it strains credulity somewhat to believe that the great establishments did not make moderate profits. The curious arrangement of the schedule of extras does seem to have given a certain opportunity to small makers; but the matter was in the hands of the great companies, and they would have changed the schedule if they had found it to work strongly against them. The strict requirement of assorted orders made it impossible for any maker of small nails only to do more than a very restricted business. If any dealer bought many nails of such a maker, he could not buy his large nails at the market price.

The days of good profit to the average man with average advantages were, however, gone by; and the manufacturers — large and small alike — were in a state of mind to yield themselves plastic to the hand that could organize the machinery for increasing profits. This hand belonged to Mr. John H. Parks of Boston, who had been a member of the old firm of Loring & Parks, long well known as manufacturers of tacks. That firm combined with their principal competitors, some six years ago, in forming the Atlas Tack Corporation, which is still the giant of the tack trade; though the leading men connected with it have thought it well during the last few months to put it through a receivership and a reorganization, with the usual absorption of the interests of the smaller investors. For several years past, Mr. Parks has confined his personal attention to the promotion of combinations in various lines of hardware. Bolts and shovels, as well as tacks and nails, have known his supple hand. From a time early in the spring of 1895, he seems to have been busy in working up an agreement among the manufacturers of nails. The approaching consummation of this enterprise was announced on May 2, through the *Iron Age*, in the following words:

> With a view to securing a better condition of things and correcting influences which hitherto have tended toward irregularity in prices and the unsettling of the market, the manufacturers have been conferring with a view to concerted action in this direction.

The combination began its activity with the customary declaration as to its moderate purposes with respect to price. In the article from which I have quoted, this vital matter is thus dealt with: "The manufacturers directly concerned in the movement disclaim any intention of advancing prices unreasonably, their purpose being to market their goods at a reasonable profit."

The first effect of the rise of the combination was a press of orders. Many jobbers bought all the nails that they expected to need for six months or more. From about May 1 the manufacturers refused to accept any orders for shipment later than May 30. By May 15 the base price had risen to \$.95; and by

the 20th it had become so difficult to place large orders that there was no quotable price. Some sales were, however, reported about this time at $1.15 to $1.20 The combination was formally completed in the last week of May, and the base price for June was fixed at $1.20, for car lots, f. o. b. Pittsburg. All nails, no matter from what mill, were to be sold, freight paid, on the basis of the Pittsburg price, plus the rate of freight from Pittsburg to the point of destination. For instance, a customer at Anderson, Ind., would have to pay a base price, consisting of $1.20 plus the rate of freight from Pittsburg to Anderson, whether he bought in Pittsburg, or in Cleveland, or from the mill in his own town. Jobbers were allowed a discount of five cents per keg on purchases of a thousand kegs from one mill within one calendar month; and the minimum was soon reduced to five hundred kegs. In addition, a rebate of ten cents per keg, payable after six months, was offered to jobbers who should neither buy any nails from outside makers nor sell below the association price.

The form of the association was that of a simple pool. Prices and output were always fixed for a month in advance. The agreed production was apportioned to the companies on a basis depending partly on sales for three months before the pool was formed, partly on production in one of those three months, and partly on capacity as indicated by the number of machines. Any mill could sell its privilege of production, or any part of it; but every mill was rigidly restricted to its allotment during each calendar month, unless it bought the allotment of another. A cost price was assumed, which was supposed to represent the cost of production at Pittsburg; and the cost at every other point was assumed to be equivalent to the Pittsburg cost with freight from Pittsburg added. This was because the raw material comes chiefly from the Pittsburg region. So the selling price, including delivery at the buyer's railroad station, and the assumed cost price were harmonized by the use of the Pittsburg base. All the profits, above the cost prices so arrived at, were paid into the pool; and the amount in the pool, after paying all expenses, was divided monthly. The basis of division was the same as the basis for the allotment of production.

An inspector, hired by the association, was placed at each association mill, with the most sweeping powers of investigation. Every part of the mill, every book, every letter written or received, was open to him. So far as possible, outside owners of nail machines were hired to keep them idle, and makers of machines were hired to refuse orders for them from persons outside the association. For a year it was very difficult to buy a machine, and while the association lasted it was never easy. A company which went into the business in the autumn of 1896 writes:

> We found the market in which we could buy machines was very limited, most of the machine manufacturers having entered into an arrangement with the combination to stop making them for outside parties. We were unable to obtain what we wanted, and consequently our production of nails was much below what we intended it to be when we started.

With a similar combination of Canadian nail manufacturers, the association made an agreement by which each bound itself not to offer goods in the territory of the other. Efforts were also made to induce the European manufacturers to agree to let none of their nails come to America. Although it is said that they did not meet with much success, only one large lot of nails and a few small lots were actually imported during the existence of the pool.

The agreement of the wire-nail men was accompanied by a similar agreement of the cut-nail men. Although separate in form, these two organizations acted as one. The price of cut nails was accordingly advanced with that of wire nails, at first 20 cents below, and afterwards uniformly 25 cents below — a difference not relatively greater than that which had existed before the pool was formed. Wire nails were so far preferred that, in spite of the difference in price, their competition had reduced the trade in cut nails to a fraction of its former size, and had thrown hundreds of cut-nail machines out of use. The existence of these machines was one of the chief sources of embarrassment to the two associations. The wire-nail pool had to turn over large sums to its weaker associate, to be used in

paying the owners of these old cut-nail machines to keep them idle.

The demand for nails continued very strong through June. The production for the month had been restricted somewhat, in order to insure control of the market. Before the 12th the mills had sold their entire allotments for the month and were refusing all orders.[1] Yet, at their meeting held the week following, they made a further restriction of their output for July, reducing it to about half the average monthly product for the previous year,[2] and fixing the price for July at $1.55. Dealers anticipated a further advance, and in their desire to protect themselves clamored for nails. Before July 4 some manufacturers had sold their entire allotment for the month and were again refusing orders. By the 10th, few nails could be bought from manufacturers.[3] On July 18 a new "card," or schedule of extras, was adopted. The extras on 10-d. and smaller nails were not changed; but all larger sizes were put on an equality with 10-d., with an extra of 50 cents. The requirement of assorted orders, or a minimum average of extras, was abolished; but the lowest extra was now almost up to the old required average. The base price for August was made $2.05.

The success of the nail combination had been followed by a sharp and general advance in the prices of iron and steel products, and had doubtless contributed to cause it. A market report of May 30 said: "Billets are $17.50 and will likely be higher, and the agreement reached by the wire-nail mills is also having its effect on rods, and prices are very much higher."[4] Between May 1 and August 1 plain wire, from which nails are made, rose from a base price of $1.10 per cwt. to $1.50; wire rods, from which wire is drawn, from $21.00 per gross ton to $29.00; steel billets, from which rods are rolled, from $15.50 per gross ton to $21.50. There seems to have been what is called a good understanding between the producers in these lines, but no formal combination. On August 22, however, this announcement appeared: "The barb-wire trade has been organized on the same lines as the wire-nail trade. A sharp

[1] *Iron Age*, June 13, 1895, p. 1248.
[2] *Ibid.*, July 11, 1895, p. 85.
[3] *Ibid.*
[4] *Ibid.*, May 30, 1895, p. 1143.

advance in prices has been made. Plain wire will likely advance in sympathy with barb wire."[1] On September 5 it was announced that prices of plain wire had been advanced, "as the result of an understanding arrived at by the manufacturers." The base price of wire nails was advanced to $2.25 on September 1, "in view of the increased cost of raw material." The demand had continued good during August. In the latter part of the month, in consequence of the restriction of output, there had been some scarcity. In September the demand began to fall off notably, but the mills disposed of their allotments for the month. Trade was poor in October, and in November it was very light. The manufacturers complained particularly of the large stocks which the jobbers had on hand, and which some of them were offering rather under the combination price. The pool was strengthened in November, however, by the accession of several companies which had been operating outside.

About November 25 the only large lot of nails which has been imported into this country in many years was received by the Bigelow & Dowse Co., of Boston. Rumor puts the amount at about 5000 kegs, or 20 carloads. Several small lots were received at New York during the next year, but the largest is not believed to have exceeded 500 kegs. It is not known by what means the Bigelow & Dowse Co. were convinced that it would be better not to repeat their operation; but apparently they did not cut the association price, and they brought in no more nails. Jobbers, who investigated the matter with a view to importing, say that English nails could not at any time have been imported with profit, but that German and Belgian nails could have been laid down in Boston or New York at from 50 to 70 cents below the highest price reached by the pool, even after paying the duty of 25 per cent. It required more courage than appears at first sight, however, to venture on placing foreign orders. The German and Belgian nails are shipped in bags, and to make them salable in the American market they must be kegged after receipt, at an expense of from 10 to 20 cents a keg. The head is formed a little differently from that of the American nail, and the tendency of human nature to

[1] *Iron Age*, Aug. 22, 1895, p. 404.

reject the unaccustomed might cause some objection to it. But the chief deterrent of imports, aside from the tariff, was the power of the pool to drop the price at any time to a point that would cause the importer a very serious loss. Nothing would have been so likely to cause a drop as the fact that large foreign orders were being placed.

The duty on nails does not now serve any purpose except to increase the power of combinations. Nails are produced here as cheaply as anywhere in the world, and are regularly exported. The duty does not protect the industry, and under full competition does not affect the price. But if there had been no duty when the pool was organized, either it would not have been organized, or it would have had to content itself with a much more moderate advance. An excessive advance would have caused the other obstacles to importation to be overcome, and would have led to free purchases abroad.

In December the manufacturers gave jobbers a guaranty on their December purchases against decline in January: that is, they agreed that, if they made a reduction of price in January, they would give jobbers a corresponding rebate on such nails bought in December as they had still on hand. This policy was thereafter followed from month to month till near the breaking up of the association. It was meant to induce freer buying by the jobbers; but its success was slight. The demand for nails was exceedingly light during the winter, and the stagnation propagated itself back to the market for raw material. In a market report of January 2, 1896, is this remark: "Until there is an improvement in the wire and wire-nail trades, it is not likely there will be any demand for rods." On January 16 it was stated from Pittsburg that no sales of rods had been reported in that market for some time. Early in February the nail association announced an advance of 15 cents, to take effect March 1. This galvanized the market into a mild, convulsive movement. The operation was repeated in April, with an announcement of an advance of 15 cents to take effect May 1. Trade was very dull, however, and the manufacturers admitted that the market was a good deal disturbed by outside nails and by the offerings of jobbers. High prices had so curtailed con-

sumption that a considerable quantity of nails, bought before the pool was formed or in its early days, was probably still in the jobbers' hands. These formed a disturbing element, in addition to the growing production of outside factories.

About April 1, 1896, the makers of steel billets formed a pool. The amount of billets in the hands of middlemen, or contracted for by them, was so great, however, that the attempt of the pool to raise prices $3 or more per ton was only partially successful. The wire-rod makers also tried to form a pool, but after much negotiation were unable to agree. Their good understanding, however, seems to have continued.

Early in June the nail association succeeded in coming to terms with the Pittsburg Wire Co. and Baackes & Co., of Pittsburg, by which these companies agreed to stop making wire nails. Their nail mills were by no means of the first rank; but they were large enough to make a considerable figure in the market under the existing circumstances of very small consumption, and they had been selling somewhat below the association price.

If the statements of the manufacturers could be accepted freely, we should need to explain to ourselves the rather curious phenomenon of producers keeping the price of their product abnormally high, contrary to their own desires, in deference to the wishes of their customers. It was semi-officially announced that while the manufacturers came to their meeting on June 3

> with the general expectation that some action would be taken looking toward a reduction in price, they were confronted with many letters from jobbers emphasizing the injury that would be done to the market by the reduction in the price of so staple a commodity as nails, and urging the manufacturers to maintain existing prices.[1]

Such a phenomenon would not have been inexplicable if it had existed; but an examination of twenty-nine letters of jobbers on the situation, published about that time, indicates that it was essentially a myth. Two of these regarded the price as a matter which concerned no one except the manufacturers, and which no one else ought to trouble himself about. Only seven could be counted against an instant reduction, on any construction of their words. Nineteen either were opposed

[1] *Iron Age*, June 11, 1896, p. 1384.

to the existing high prices or at least went so far as to say that, if a reduction were to come before January 1 (a matter on which they expressed no opinion), it had better come at once. The retailers were unanimous for reduction, complaining of a great falling off in their sales, which some put as high as fifty per cent. They reported that building and repairing were much interfered with.

Meantime a growing number of small mills gave the association increasing annoyance. By July 1 it was estimated that 25,000 kegs a month were made by outside mills. The total sales for June, by the association and outsiders, were estimated at 90,000 kegs;[1] while it was said that the allotment for July was 65,000 kegs,[2] and that the associated manufacturers did not sell so many.[3] These statements were made by the Pittsburg office of the *Iron Age*, which was at the centre of the movement, and which ought not, it would seem, to have sent out any but well-founded statements — at least about matters so definitely fixed as the monthly allotment. There is reason, however, for supposing that these figures were too low. A man who knows the innermost history of the combination has said that he does not think there was any month in which the manufacturers in the pool did not sell 150,000 kegs. This statement seems modest enough, considering that the average monthly production for 1895 was nearly 500,000 kegs.

Rumors of concessions and irregularities in price increased. On September 1 the guaranty to jobbers on each month's purchases against decline in the succeeding month was discontinued. It was noted with satisfaction that, in spite of the low prices which had to be made to meet foreign competition, the export trade was assuming relatively large proportions.[4] Early in September several outside manufacturers were induced, on expensive terms, to withdraw from the market. It was claimed that the production of those still outside was insignificant; but, in spite of this claim, the association lost its grip on prices to an extent far greater than at any earlier time. Chicago was the centre of greatest disturbance. Nails were openly offered there by jobbers

[1] *Iron Age*, July 23, 1896, p. 186.
[2] *Ibid.*, July 30, 1896, p. 236.
[3] *Ibid.*, Aug. 13, 1896, p. 334.
[4] *Ibid.*, Sept. 10, p. 512.

at $2.50, and finally at $2.25, for small lots from store, for which the association price was $2.80. The demand, however, showed a great improvement in September, and it continued good in October. It was estimated that the total output for October would be about 250,000 kegs,[1] or about half the average monthly output for 1895. Soon after October 1, the manufacturers succeeded in patching up the trouble at Chicago; and about the 15th the market reports said that there was "not a suspicion of weakness in any direction," and that the association had "demonstrated its ability to control the situation." It was, nevertheless, hardly two weeks before the final break appeared. About November 1 Chicago jobbers began to offer nails from store at $2.40. The break spread rapidly, and by the 10th the association price was merely nominal. Demand continued light. No one bought more nails than he had to have, because to-day's price was always likely to be bettered to-morrow. About November 20 nails were openly offered at Chicago at $1.50 by representatives of association mills. On December 1 the association held its last meeting, adopted a new card of extras, and formally dissolved. The new extras on common nails are as follows:

20-d. to 60-d.	base
10-d. " 16-d.	$.05
8-d. and 9-d.	.10
6-d. " 7-d.	.20
4-d. " 5-d.	.30
3-d.	.45
2-d.	.70

This schedule makes a large reduction in the relative price of small nails, which was undoubtedly intended to shut out the small manufacturers who had been making small nails only. The new card, however, comes much nearer than any previous one to representing the relative cost of large and small nails, under present conditions of manufacture.

II. The Course of Prices

When it is said that nails were selling on May 1, 1895, at $.85, and that on May 1, 1896, the association made the price

[1] *Iron Age*, Oct. 29, 1896, p. 837.

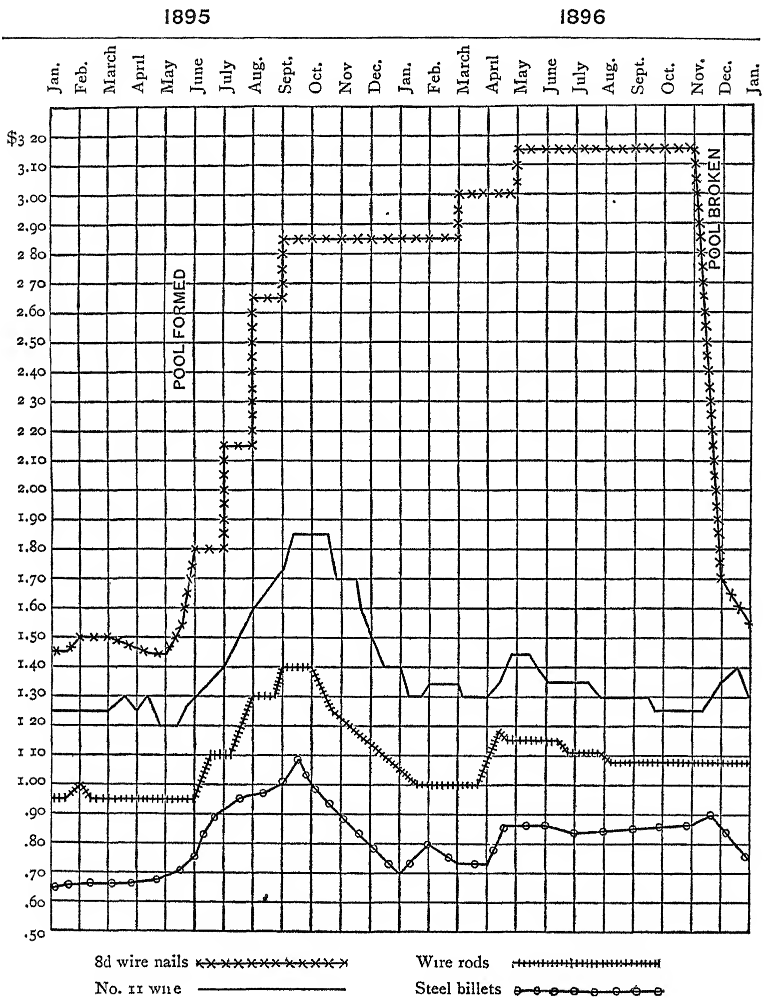
$2.55, the price appears to have been multiplied within a year exactly by three. The case looks still worse when it is said that 60-d. nails sold in 1895 for $.85 a keg, and in 1896 for $3.05. In reality, while an ordinary bill of nails would have cost on May 1, 1896, at least $1.70 per keg more than a year earlier, it would not have cost three times as much. No nails were sold at the nominal base price in 1896; and though 60-d. nails were nominally sold at the base rate before the change of card in 1895, the statement that the price of 60-d. nails was at one time $.85 gives a false impression, for reasons which I have explained. A comparison of base prices after December 1, 1896, with earlier ones is altogether misleading, because the present extras are much smaller. It has been estimated that a well-assorted order of nails would carry an average extra of about $.62 on the old card, $.70 on that of July 19, 1895, and $.12 on that of December 1, 1896.[1] Perhaps there is no better simple measure of the actual course of the market than the change in the price of 8-d. nails. This size is used in large quantities; and when assorted orders were required, the extra on it was the same as the required average of extras. But this does not give a perfectly true idea of the changes of price. It is necessary to remember that during the life of the association the prices of the larger nails were increased even more by the increase of the extras on them.

The diagram printed below shows the movement during 1895 and 1896 of the prices of 8-d. wire nails, of No. 11 wire, from which these nails are made, of wire rods and of steel billets. It is based upon the Pittsburg quotations, as published from week to week in the *Iron Age*. No. 11 wire costs about $.10 per cwt. more than the base sizes quoted in the market reports.

Iron and steel went through a notable boom and collapse in 1895. Without any marked change in the general condition of the country, without any corresponding change in general prices, without any strong parallel movement in other countries, the prices of crude iron and steel, and other prices directly dependent on them, rose fast and steadily for some five months, and fell even faster in the next three. Between April 1 and September

[1] *Iron Age*, Dec. 10, 1896, p. 1161.

15 steel billets rose more than sixty per cent, while by December 15 they were within ten per cent of the old level. It is not easy



to get a fully satisfactory explanation of the rise. Near the end of March the Carnegie interests contributed to start it by very

large purchases of iron. About the same time the H. C. Frick Coke Company announced an advance of fifteen per cent in wages, and an advance of more than thirty per cent in the price of coke, to take effect April 1;[1] and other coke shippers followed their lead. This made a great increase in the cost of producing and working iron and steel. A little later labor disputes threatened to stop production; and when they were settled, it was by an advance of wages. Other advances were announced by the great steel companies during May and June. These increases seemed to justify and to fasten the higher prices. Men gathered confidence that good times were coming, and that prices were not only to stay up, but to go higher. This confidence, reacting, bred demand; and renewed demand pushed prices higher and higher. The success of the nail combination, and the temporary activity which the advance in nails and the expectation of advance occasioned in the market, were among the causes which contributed to these phenomena. It is doubtful whether the rise of raw material had the slightest influence upon the price of nails; for the rise of nails began before that of steel, was eminently artificial, and was continued after the raw material had sunk nearly to its former price.

III. The Interests of Dealers and Laborers

The undesirability, from the standpoint of those who want to use nails, of any restriction upon the use of them and of having to pay high prices to get them, is too obvious to be insisted on. The retail hardware dealers suffered with the consumers. Their sales were curtailed, without a proportionate increase in their profit per pound. They had to bear the brunt of their customers' complaints about the price of nails. They complained, also, of the annoyance which was caused by the new card of extras, under which the cheapest nails cost fifty cents per keg more than the nominal base price. When their customers saw nails quoted in the papers at $2.25, it was hard to convince them that the actual wholesale price of 60-d. spikes

[1] *Iron Age*, March 21, 1895, p. 607.

was $2.75 The jobbers, on the other hand, made large profits on the stocks which they bought before the pool was formed, or soon after; and they were enabled, by the system of discounts and rebates, which the manufacturers maintained, to make at least their usual profit on current purchases. This policy was meant to make the jobbers friendly to the association; and it seems to have been largely successful.

Some of the mills showed a disposition to raise wages as they advanced their prices, and so to make some little division of profits with their men. It was reported that one of the great companies gave its men an advance of ten per cent in June, 1895,[1] and ten per cent more about March 1, 1896;[2] that another raised wages ten per cent in July, 1895;[3] and that a third, after a strike, in September, 1895, advanced its wire-drawers ten per cent and fifteen per cent, and its nail-makers five per cent.[4] But the last-mentioned company, which at its full capacity employs about one thousand hands, at one time cut down its force to about three hundred. This reduction is proportional to the reduction of total sales from 500,000 kegs a month to 150,000. It seems safe to assume that the other companies must have made similar reductions. If half or two-thirds of the laborers were thus thrown out of work, they were not much helped by a small increase in the rate of wages paid to the rest.

The restriction of the employment of labor did not stop at the nail mills; there was a diffused effect which was probably greater, though it is less traceable. There is reason to believe that building, and especially repairing, were perceptibly retarded.[5] To raise the retail price of a keg of nails, say from two dollars to four, must under any circumstances diminish purchases to some extent. The effect will be greater if the circumstances make it seem likely that the rise is temporary. In the present case, there was the added influence of a lively conviction of the buyers that the manufacturers were trying to rob them. If a man thinks that an effort is made to impose upon him, he

[1] *Iron Age*, June 20, 1895, p. 1288.
[2] *Ibid.*, March 12, 1896, p. 656.
[3] *Ibid.*, July 18, 1895, p. 129.
[4] *Ibid.*, Sept. 5, 1895, p. 496.
[5] *Ibid*, June 25, 1896, pp. 1490–1493.

will often subject himself to a good deal of inconvenience, for the satisfaction of thinking that he has not been imposed on. It is likely that thousands of men did without improvements which they could not afford to do without, because they would not submit to what they regarded as the arbitrary demands of the nail combination. It was, perhaps, in part because the manufacturers left this moral effect out of their reckoning, that the extent of the diminution of demand took them by surprise. Their calculations doubtless accorded with the view recently expressed by a small manufacturer, who experienced a strong demand while the association lasted, because he sold nails a little under the association price. He said:

I do not think that the high price of nails restricted consumption to any perceptible extent. The item of nails in the cost of building is a very small one, and it was not over five or six years ago that the price was about the same as that fixed by the recent combination.

Consumption was not so small as production during the last months of 1895, or perhaps during the early months of 1896, while the jobbers still had some part of the stocks which they had laid in about the time the pool was formed. But the best information obtainable makes it appear that, during 1896, consumption as well as production must have been small beyond any possible expectation.

IV. The Interest of the Manufacturers

It is apparently the general opinion that, quite aside from any consideration of the public welfare, and looking only to the pecuniary interest of the manufacturers, the combination carried the policy of high prices too far. The association went to pieces after eighteen months, and prices went down to their former level; therefore it is assumed that the combination failed or, at least, that it would have accomplished its purpose more fully by a more moderate policy. The matter does not seem to me so simple. Mr. Parks, who was undoubtedly the guiding spirit in the whole transaction, went into it with eyes very wide open. He had already been connected with several tack combinations managed on the same principles. Of course they came

to a rather speedy end; but Mr. Parks seems to have counted their experience as favorable, on the whole, to the policy of a short life and a merry one for pools. Moreover, he still maintains the wisdom of the course that he counselled. When the association collapsed, he said that it had lived longer than its most sanguine promoters expected, and as a financial undertaking had been an unprecedented success.[1] The manner of argument of a man who was connected with the association throughout its existence is as follows:

> Suppose we had put up the price $.15 a keg. A great many men who had had their eye on the nail business, would have said: "Those men have put up the price $.15, and they will probably make it $.25. There is going to be money in the nail business. I will go in." But when we put up the price $1.50, they said: "Those fellows are lunatics. They can't hold together. There will be a smash before they get fairly started. I will keep out of that business." As a matter of fact, we had hardly any new competition during the first year of the association. The new competition came mostly after the beginning of the second year. Then men began to say: "Those fellows have kept together twelve months, and they will probably do it a while longer. They are making a lot of money. I will try to get a slice of it." I am sure we kept the association going longer with a high price than we could have kept it going with a low price. I don't believe it would have lasted six months with a raise of $.25. The high price frightened off some people, and gave us plenty of money to buy off the rest.

It is hardly possible to over-emphasize the distinction between the great consolidations of which the so-called sugar trust may be taken as a type — consolidations which it may not be improper to distinguish specifically as trusts, because the typical examples were first united under the proper trust form of organization — and pools like the nail association. The broad differences of organization have their root partly in the conditions of the businesses concerned, and partly, it may be, in the mental characteristics of the managers; and they issue in great differences of policy and power. It would probably not be impossible to bring the making of wire nails under the control of one great company; but it would be much more difficult than it was to do the like

[1] *Iron Age*, Dec. 3, 1896, p. 1108.

with the refining of sugar. To refine sugar by methods commercially practicable to-day, a man must have hundreds of thousands of dollars to put at the risk of the business. With ten thousand dollars and six weeks' time, however, any man who likes can become a manufacturer of wire nails. A little factory can make them, not quite so cheaply as the great establishments which make their own wire, but at no very great disadvantage. It needs only a small rise above the lowest price at which the best mills can pay interest on the cost of their plants, to enable an indefinite number of small mills to start, making each its twenty-five or fifty kegs per day. This is the weakness of any form of combination in a business of this character — the possibility of a new factory in every thriving town.

No limit can be named to the success of skilful and determined managers of a centralized combination or trust, in any line, in crushing competition. An abnormal lowering of price in the local field of a small competitor is a weapon which needs nothing but persistence to make it inevitably fatal to him; and the revenues which the trust draws constantly from other fields, even if it loses in the region of cut prices, give it an unlimited power of persistence. There is no doubt of the trust's ability to destroy any competitor of a size which does not approach its own. This process is troublesome, however, and somewhat expensive; and in a case in which new competitors can spring up with so little money and in so short a time, the query is whether the situation of the trust would not be unpleasantly like that of a man fighting with mosquitoes.

It probably would be so, unless the trust should be content with a policy of greater moderation in its profits than any trust has yet had the self-denial to adopt. Any trust, having once got control of the market, could make it impossible for any competitor to establish a business which would pay a profit for a day, or would need any attention from the trust to make it disappear. This possibility depends upon the power of the trust to do for society such service as no competitor could do. The representatives of the trusts have not been negligent in setting forth the economies which they are able to effect: the production of all goods by the most efficient plants; the uni-

versal use of all improvements, patented or not; the economizing and full use of expert knowledge; the incorporation of subsidiary industries, like the making of packages; the saving of transportation by shipping from the factory nearest the consumer. Greatest of all, perhaps, and most decisive, because it is the economy that is absolutely out of the reach of a competitor, is the commercial economy that depends upon the control of the market — the saving of the expense of inducing customers to buy of this concern and not of that. A trust which should make over the greater part of these savings to its customers, and should content itself with prices which would give it only fifteen or twenty per cent per annum on the value of its productive property, as measured by the cost of replacing it, would probably never be troubled with any shadow of competition. But the general conclusion of competent and disinterested investigators seems to be that, up to the present time, every trust, when its control of the market has been established, has not only kept the whole of the savings of consolidation to itself, but has taken from the public something besides, making prices somewhat higher than they would have been under full competition.

The form of organization of a pool is less unattractive than that of a full consolidation, to a man who values his independent position and dislikes to become an employee; but there is in it as much less power as there is less unity. Under a pool, the economy of closing some establishments may be effected by paying them a bonus, as was done for years by the steel-rail pool. The nail men dealt with outside mills by this plan, but under circumstances and in a way which hardly permit it to be regarded as an economy. It is probable that a pool, with production strictly limited to what the market will easily absorb at the prices fixed, might make some saving in the commercial expenses of advertising and selling, particularly if the circumstances and the policy of the pool were such as to give it a character of comparative permanence. The nail men were probably not able to make any savings of this class. The other economies which are possible to a trust seem to be out of the reach of a pool, while the central organization and the

system of mutual watching seem even to add something to the cost of superintendence. It is probably safe to say that nearly all the gain which any manufacturers may make through a pool is made by raising their selling prices.

It can be maintained with a good show of reason that the nail men would have got more profit in the course of years from the policy of full consolidation, with prices permanently fixed low enough to make competition impossible. But experience has not yet shown this policy to be practically attainable in our present stage of civilization. Between that extreme and the other, which the nail men chose, it is doubtful whether there is any mean which they would have found golden. The choice practically open to them appears to have lain between a tolerably large profit, which might possibly last two or three years, and a very large one, which might be expected to last six months or a year. They chose the very large one; and they kept it, or at least kept the price up, for eighteen months. It is true that a very large part of the profits, especially in the later months, was consumed in subsidies and other expenses of the association. Some well-informed men, intimately connected with the trade and friendly to the manufacturers, think that their policy was short-sighted. The question has more sides than one, however, and it seems possible to make out a very good case for the view that the manufacturers did not choose the least profitable course.

V. The Interest of the Public

It may not make much difference to the manufacturer whether he reduces his costs or raises his selling price; but it makes a great difference to the consumer. Aside from any lowering of prices, it is to the public interest that economies be made — that a given product be obtained with less cost and less exertion. If a consolidated trust would sell as cheaply as competing producers would have to sell, keeping to itself the whole of its economies but taking nothing more, the economies would benefit the public somewhat in the end. The production of wealth and the sum of capital are certainly increased by them; and such increase of

capital and of production tends in itself to the general good. The actual policy of the trusts, in taking from the public something in higher prices besides their gain through saving, complicates the question; but there is a very considerable gulf between the effects of a trust, like the American Sugar Refining Co., and the effects of a pool, like the Nail association. The actual lessening of the human effort that is required for a given result does accompany the trust, and we all are privileged at least to cherish the pious hope that some small fraction of the gain may ultimately work its way around to us. The pool, on the other hand, does not effect any saving of human effort. Its avowed purpose is to increase its members' share of the products of such effort. Its form of organization is probably incapable of producing the greater part of the social benefits which the trusts lay claim to; and it does not make much pretence of trying to produce them.

The claim of the trusts to a socially desirable effect on price takes two forms — that they make prices lower and that they make them steadier. The former effect has probably not appeared permanently in any instance; and the latter does not seem to have appeared generally. Both effects are, however, within their power. Unsteadiness of price, so far as it results from the action of trusts which have once established their control of the market, is generally the result of high prices. The raising of prices above the competitive level causes competition to develop; and competition can be dislodged only by buying it out or by sinking prices below the competitive level. The trusts are regarded by their managers as permanent institutions, and they tend toward the policy which the managers think likely to bring the greatest net revenue in the long run. They tend toward a comparatively moderate forcing of present profits, with a fair degree of attention to the future. In consequence, if the prices of their goods are not steadier than they would be under full competition, they are probably not much less steady. The nail pool, on the other hand, was an ephemeral thing, designed for a quick rush into the market, a grasping of whatever gains might be within reach, and then — collapse. Its purpose was that of a corner — to get the greatest possible amount of profit out of those who had to have nails within a limited time. Its

effect, therefore, was a great exaggeration of the normal unsteadiness of prices.

Too great productive capacity is one of the reasons which are regularly given for forming combinations. The providing of machinery for making far more goods than are demanded at the necessary prices is one of the wastes of competition. Of course it would not be practicable, with the completest centralization, to keep the nominal capacity of machinery down to the actual demand; for variations in the quantities demanded, variations in the kinds demanded, the necessity of being able to make many kinds at each of several places — all forbid an exact adjustment. There is no doubt, however, that here a trust can effect a saving over competitive methods, though it may nullify this benefit more or less completely by stimulating new competition through too high prices. The policy of the nail pool, on the other hand, greatly stimulated the tendency to the overproduction of machinery. The association tried to check it by subsidies to machinery-makers, but with only partial success. Such makers of nail machinery as would accept orders were overwhelmed with them. It was said that persons anxious to get into the nail business "overbid each other, and lucky buyers of machines were offered premiums for their bargains." [1] When the pool collapsed, the machines which the artificially stimulated demand had called forth became, for the most part, dead property. Both to the owners and to society, they are an almost entire waste of capital.

In this way the pool aggravated one of the fundamental difficulties of the situation which it was formed to change. This is, perhaps, its most visibly lasting effect, and from it a serious obstacle arises in the way of renewing the pool. So far as their current business is concerned, the manufacturers might have been in no very different position if the pool had not been formed. The price of nails is now about the same, allowing for the change of extras, as in the spring of 1895. Of the hundreds of new machines which were set up during the eighteen months of fever, a large part have ceased to turn out nails, and as the months go by, others will cease. Some of the older

[1] *Iron Age*, Dec. 10, 1896, p. 1147.

and less efficient will go, one by one, to the scrap pile, and some of the newer may replace them. With the continued progress of invention the rest will doubtless grow relatively less and less efficient. The growth of the country, too, will make a fixed number of machines continually less important as a possible factor in the market. These, however, are processes of years. For a long time to come the hundreds of machines which stand ready to start at a week's notice must be reckoned with by any new combination. A small manufacturer, who was not in the pool, wrote in February, 1897: "I doubt if there will be another combine for a year, but I think it will ultimately come." It will come, as surely as seedtime and harvest; but not in one year, nor, in all probability, in two. It will probably not be possible, until several years have gone by, to form another association which shall effectively control the market.

VI. Conclusions

Only two rather small classes are probably ready to give thanks for the concentrations of industrial and social power which are loosely covered by the name of trusts — those who draw wealth and power from them, and those who, desiring a general absorption of the control of production by society, think that the trusts are forwarding their aim; and some of the former class perhaps would not give thanks without certain haltings of conscience, while many of the latter account the case as one of those in which God makes the wrath of man to praise him. But an unfavorable judgment of the economic and social effects of an institution does not at all involve an unfavorable ethical judgment of the men who visibly represent it — at least in comparison with the rest of the community. The members of the Nail association did what the rest of us would have done in their places. One who was active in forming the association gives this statement of their point of view:

There is nail machinery enough in this country to produce four times as many nails as can be sold. When there is no pool the makers simply cut each other's throats. Some people think there is something wicked

> about pools. When we were trying to get up the nail pool, I talked with directors of companies who held up their hands against going into any sort of combination. I said to them, "How much did you make last year?" "Not a cent." "Are you making anything now?" "No." "Well, what do you propose to do? Sit here and lose what capital you have got in the business?" Some of them thought they could run along until some of the weak concerns died off. But I tell you plants don't die. If a concern fails, they reorganize it. They buy in the plant cheap, they have got rid of the old debts, and they are in better shape to compete than ever. There is only one way to make any money in a business like the nail business, and that is to have a pool.

This is the aspect that things would wear to us if we were in the position of the manufacturers. Some of us are perhaps opposed to combinations; but so were some that went into the nail pool. In weighing any man's opposition to combinations, it may be doubted whether it is of the sort to keep him out of them, till he has sailed the strait between failing profits and the trust, and has passed the siren voice.

The trusts simply do, with larger resources and higher organization, the things that every manager of a competitive business is trying to do. It is possible that we see the character of such things better when they are done on the larger scale; it may be one of the missions of the trusts to give us clearer and higher notions of ethics. But it seems probable that, if we begin to cast stones, the houses of the trusts will not be the only ones to suffer. If it is asserted to be wrong to crowd up the prices of the things we sell and to crowd down the prices of things we buy, wrong to make our business large by the destruction of our neighbor's, a good deal may be said for the ethical superiority of the altruistic man who should refuse to do these things; but no ethical distinction can be drawn between the man who does them strongly and successfully and the man who is only able to do them with less strength and less success.

The mechanism of the trust, properly so called, is perhaps not unworthy to be ranked among the greatest inventions of this century, either as a monument of intellectual acuteness or as an engine of momentous social effects. Like most of those other inventions which are more unanimously classed as useful,

and for which individuals get credit, the invention of the trust did not really depend on the activity of any particular men. If neither Bell, nor Reis, nor McDonough, nor Edison had lived, a score of other men were looking for the telephone, and would soon have discovered it. Scientific and technical knowledge had reached a point from which it could not but be discovered; and no man could do more than hasten the discovery by a little. Just so, the development of the pool, the trust, and the giant consolidated corporation was inevitable in the social and economic conditions of our age. If the world had lacked Mr. Rockefeller and his associates, it had other men of business and other lawyers; and it would not long have lacked the trust.

CHARLES E. EDGERTON.

IV

INDUSTRIAL POOLING AGREEMENTS[1]

POOLING agreements are occasionally brought to light by the courts; but a large number live and die in obscurity, without interference, and without attracting attention from the general public. This form of combination has been strengthened and extended simultaneously with the growth in size of our manufacturing companies. The present industrial combinations, which succeeded the downfall of the trust organizations condemned by the courts more than a decade ago, have not obviated the necessity for these pooling agreements. As a matter of fact they seem at the present time rather to have stimulated a revival; for a considerable number of combinations are now parties to the very form of agreement which they were expected to supersede. For this reason, as an important factor in the determination of prices, especially at this present time of low ebb in the fortunes of the combinations formed in 1899–1900, the character and power of these agreements deserve study.

Certain features are common to nearly all forms of pooling. Manufacturers desiring to form a pool usually create an unincorporated organization, such as the Bessemer Steel Association, the Merchants' Ore Association, or the Steel Rail Association. All agree to maintain a schedule of prices fixed by the association, and to limit their production accordingly. Each manufacturer is allowed to produce (or sell) only a certain percentage of the whole output, depending upon the capacity and advantages of his plant. To prevent violation of the agreement, a money deposit is often required from each, forfeitable to the association. In many of the more intricate cases, the

[1] From the *Quarterly Journal of Economics*, Vol. XIX, 1904, pp. 111–123. The History of a Pool, a pamphlet (pages 109) reprinted from the *Iron Age*, N. Y., 1898, is an interesting description of the inside working of these organizations. — ED.

agreement is drawn up by counsel in New York, Pittsburg, or Chicago, the lawyers' offices being used as headquarters for the association. The duties of the legal firm often include, at the same time, the auditing and verification of reports from the various companies. To do this work, a large force of expert accountants may be employed. A fine is imposed where these reports show a production greater than the allotted percentage, and a corresponding bonus is given to plants producing less than their allotment.

The regular meetings of the representatives of the constituent companies are held usually in November or December, in order to adjust prices and allotments for the ensuing year. On account of the non-enforceability of the agreement the minority must be treated fairly. Their withdrawal would mean the breaking up of the association. The money deposit restrains the members from withdrawal only when under slight provocation. The affairs of the pool are handled by the united action of the ablest men in the business. Each owner can manage and develop his own plant, with every inducement to reduce expenses. He knows very closely the amount of his annual output, so that the most economical production would seem possible under such an arrangement.

Territorial division of the market was a feature of the railroad pools, but has not been adopted by many industrial associations. This end is sometimes loosely accomplished by making all factory prices uniform, and adding the freight from factory to selling place to obtain the price at that point. Thus, in the iron and steel associations, prices are usually figured from a base price at Pittsburg. The amount of the freight from this base to the selling point must be added to the base price, to obtain the selling price. For example, if the Pittsburg base price of steel plates is $1.40 per hundred pounds, and the freight from Pittsburg to Iowa is 35 cents, the price in Iowa is $1.75, whether a Chicago or a Philadelphia concern does the selling. This operates to prevent waste in transportation by keeping shipments moving in directions away from the base point. Shipments made toward it suffer a loss in selling value as well as by reason of the expense for freight. Only very strong local in-

terest can secure such a schedule, increasing still further the strength of its position.

Several pools have omitted the feature of percentage allotment, and have placed a tax upon all manufacturing. These are familiar, as they have come before the courts. In the case of the Candle Manufacturers' Association,[1] formed in Ohio in 1880, the members were required to pay into the treasury $2\frac{1}{2}$ cents for every pound of candles sold. A more modern pool, the Addyston Pipe and Steel Company, had an elaborate system by which it fixed the price that a city should pay for pipe, and then gave the contract to the member offering to pay to the pool the highest amount for it. The others put in bids to cover appearances, but took care to name a higher price than that agreed upon. Certain companies were permitted to take all the contracts let by large cities near them, called "reserve" cities. In 1899 the Sherman Act was successfully invoked to terminate this arrangement.[2]

An entirely different form of avoiding competition is through the adoption of a joint sales agent. The various firms agree to sell only through a certain agent or selling corporation. This agent contracts with each firm separately, but guarantees a uniform selling price. He also disposes of the goods from different firms in a given ratio This ratio may be fixed or may vary with agreed conditions. An exported article would be advantageously controlled in this way. An arrangement of the same sort is most common in the case of articles not patented, and of long established use and approximately standard design. The Union Blue Stone Company[3] in this way effected all the sales for the Blue Stone Association, fixing the price to be charged and the quota to be furnished by each member.

Still another form of pool is based upon patents essential to the manufacture of the article. The patentee sells the rights of use, for a uniform royalty, to all who apply. He also limits the quota to be produced by each firm, above which amount the royalty increases rapidly. Various ways by which patents may be used to control production have been adopted. Thus, for example, the United States Consolidated Seedless Raisin Com-

[1] 47 Ohio State, 320. [2] 20 U. S. 97. [3] 164 N. Y. 401.

pany was an association of nine California firms, owning all the patented raisin-seeding machinery. Members of the company paid a royalty of $\frac{1}{8}$ cent per pound, but outside firms were to pay $\frac{1}{2}$ cent. This form of agreement the courts have upheld as legal.[1] In another case — that of the National Harrow Company — the manufacturers agreed to pay to the owner of the patents, $1 royalty on each harrow sold, and $4 additional on every harrow sold for less than a stipulated price. This form of agreement, unlike the preceding one, was held to be unenforceable at law.[2]

It is common knowledge that pooling agreements of one sort or another are numerous at the present time, but the secrecy with which they are guarded makes it difficult to discover their real extent and character. A single New York law firm, a few months ago, making a specialty of these associations, superintended no less than thirty-nine, each covering some manufactured product in the metal trades. But pools are not restricted to the iron and steel business. They cover a wide range of industry. A part of Mr. C. M. Schwab's testimony before the Industrial Commission bears upon this point.[3]

In the iron and steel trade, however, there would seem to be the majority of these pooling associations and price agreements in operation. As soon as the ore is dug, it is regulated by an association. The "independent" ore producers have organized the Merchants' Ore Association of Cleveland, which adjusts their relations with each other and with other ore producers, such as the United States Steel Corporation. The association attempts to establish the price of the various grades of iron ore and to state to each "independent" the maximum amount of ore that it may produce. The price must be satisfactory to the

[1] 126 Fed. Rep. 364. [2] 76 Fed. Rep. 667.

[3] Industrial Commission Report, Vol. XIII, p. 474: "The steel rail pools were simple price agreements between the managers of the various works, to sell rails at the same price at the same point.

"*Q.* For manufacturers before the organization of the United States Steel Corporation were similar arrangements existing?

"*A.* Yes: in all lines of business, not only in steel, but in everything else. There were similar agreements, known as joint agreements, to maintain prices. They have existed in all lines of business as long as I can remember."

Steel corporation. The Merchants' Ore Association naturally desires low prices to enable it to sell the largest possible amount of product. With the steel makers owning ore deposits, the price is largely a matter of bookkeeping; but the endeavor is, nevertheless, to keep it high, in order to raise the cost of production for rival steel mills not owning mines. The price of Bessemer ore for 1903 was $4.50 per ton.[1] For 1904 the association wished it to be between $3.25 and $3.80, while the Steel corporation demanded that $4 be the price, threatening to sell ore itself. The Ore association was, however, allowed to fix it at $3.50, although several of its members made long-term contracts to deliver at a sliding scale price, fluctuating with the price of pig iron. This made it impossible for the association to adjust the allotments satisfactorily, and its continued existence was threatened.[2]

Concerning the next stage of manufacture above mining, — namely, of pig iron, — there are also price agreements among the furnace men, who have formed the Bessemer Pig Iron Association. A pool based on steel ingot production was attempted unsuccessfully. Steel billets, however, we find pooled in 1896, and again since 1900. The heavier materials — steel rails, beams, channels, angles, bars, plates of all kinds, shafting axles and rods, wire and wire fencing — are likewise all priced by pools. Among the lighter forms covered by such agreements are chains, nuts, bolts, steel hoops, and bands, pipes and tubing, and hardware. A prominent retail hardware firm stated to the writer that the hardware manufacturers had agreements as to prices covering practically everything in the store, "all shelf hardware" in fact. Judging from the iron business, we may expect to find pooling agreements developed up to the point where trade-marks, style, or individual reputation, become predominant considerations in making a market for the goods.

Four of the most important steel products — billets, rails, beams, and plates — have been specially selected in this study for more detailed analysis as to the effect of pooling upon prices.

[1] *New York Journal of Commerce*, April 22, 1904.
[2] *Iron Age*, May 5, 1904.

The appended diagram has been prepared to show the range of prices since 1890. Only a very brief review of the pools that existed during these years can be given. Were a detailed history of their operations available, the problem presented by their existence might be dealt with more intelligently.

The first billet pool was formed in April, 1896, as an attempt to remedy the extreme fluctuations in price of the year 1895. The Bessemer Steel Association, as it was called, allowed to each firm a percentage of the billet business of the country, estimated at 4,500,000 tons, and imposed a fine of $2 per ton for any excess produced. The association immediately fixed the selling price considerably higher than demand justified, at $21.50. Outside firms promptly took orders at $19.50; and there was also much selling contrary to the agreement by insiders, thereby weakening the pool from the beginning. Moreover, it was possible for the larger firms to avoid the fines for over-production by converting the steel billets into finished shapes before selling. The pool was so very ineffective that a reorganization followed; but even then the agreement could not maintain prices against a demand refusing to accede to the high figure. As the agreement applied only to Bessemer steel, the open hearth steel production was greatly stimulated. An additional open hearth capacity of 500,000 tons and a score of new outside converters helped break up the pool. The guarantee fund of $5,000 failed to prevent its collapse in December, prices falling to $15. The pool had sacrificed what business there was, and had brought out an array of new competitors.[1]

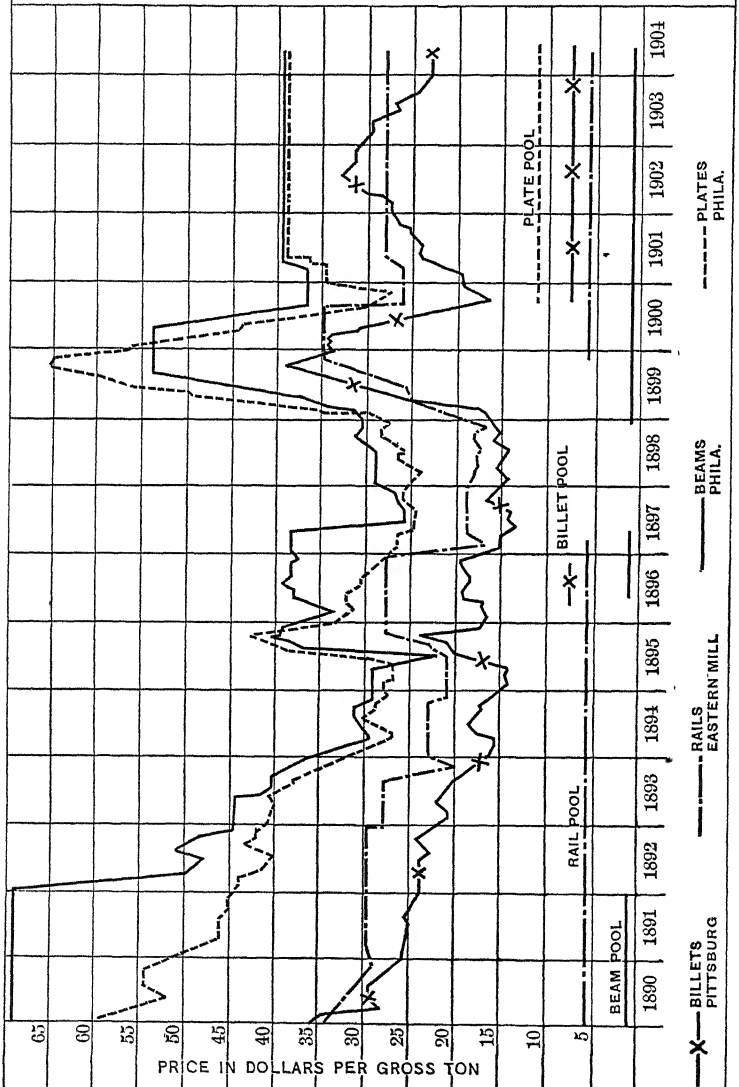
In 1899 the price of billets rose wildly from $16 to $38 per ton, and in 1900 fell no less abruptly to $16. The billet makers decided that they must attempt another agreement.[2] A base price of $19.40 was established, which was easily held, as prices began to rise. But the sliding scale device for fixing the price of billets became an important factor in 1901, the price being

[1] *Iron Age*, 1896, Vol. I, p. 875, gives the original price agreement adopted; Vol. II, p. 223, gives the difficulties encountered; Vol II, p. 967, describes the billet market, names the leading producers, and the chances of the pool.

[2] *Ibid.*, Jan. 3, 1901, gives a summary of the billet business of 1900, and conditions leading to the pool of Nov. 8, 1900.

PRICE CHART FOR ROLLED STEEL

SEE IRON AGE JANUARY 1898 TO 1902



found by adding the cost of conversion to the price of pig iron. For instance, if the price of pig iron lies between $16 and $17 per ton, the price of billets is found by adding $6.50. The larger manufacturers adopted this scale, and the subsequent existence of the billet pool has been nominal. Price agreements have been made, and hold or fail as the demand varies. The nominal price of $28, agreed upon by the pool in July, 1903, was reduced to $24 in November, and then to $23.[1] The descending lines of the price curve since 1902 show that the pool has not been able to name the market price. It seems to be shown that the outside billet supply is always very elastic, rendering the billet manufacture essentially competitive.

The rail pool shows remarkable strength, having named prices for sixteen years, with the exception of 1897 and 1898. This pool was formed in August, 1887.[2] It divided the estimated rail demand among the fifteen members, in agreed proportions. The fixing of prices was not part of the written contract, but informal agreements were entered into. A penalty of $1.50 to $2.50 per ton for all excess of allotment kept the firms from cutting prices in order to secure more business. In regard to prices during the existence of this combination the *Iron Age* remarks: "The price that was asked for rails by the mills was decidedly reasonable. Manufacturers whose demand varies ought not to starve the mills in poor times." The agreement came to an end in 1893, but was renewed after a sharp fight. Increasing difficulty was met in adjusting the allotments during the following years. Outside concerns had to be bought off or subsidized until, in 1896, $1,000,000 was spent in this way. It had been estimated that the demand for that year would be about 2,200,000 tons, but it was actually only 800,000 tons. Concerns that had produced little, and expected heavy bonuses, found that they had to pay a penalty. The dissatisfaction re-

[1] The *Journal of Commerce*, April 8, 1904, reports a meeting of the pool, naming the members. The present agreement includes the United States Steel Corporation, Jones & Laughlin's, Wheeling Steel and Iron Company, Cambria Steel Company, Lackawanna Steel Company, Pennsylvania Steel Company, and Maryland Steel Company.

[2] *Iron Age* of Nov. 16, 1893, gives full details.

sulted in secret cutting of prices and the breaking up of the pool.[1] There was immediate talk of renewal; but it was not attempted until prices began to rise in 1899, when the present pool was formed.[2] *

The contrast between the billet and the rail price curves is very striking. The former is irregular, showing constant fluctuations; while the latter is made up of long horizontal lines, with abrupt changes, showing that the effect of the pool was to steady prices for considerable periods. In justice to the rail pool it should be noted that in 1901 and 1902, when billets rose from $20 to $32, the price of rails remained $28. The price of beams was also held, but the plate pool raised the price $4. Agreements hold well in the rail business, because it is confined to less than a dozen firms, and is comparatively easy to control.[3] Rails are sold direct to the consumer; and, moreover, special freight rates may have helped to keep up the market price of this product.

The beam pool was organized soon after the rail pool by the mills rolling structural steel shapes, such as I-beams and channels. The $70 figure of 1890 was a pool price, maintained under small demand, by eleven firms producing nine-tenths of the supply. Foreign beams began to be imported in 1891 at $46; and, to stop this, the pool agreed to lower the price to $56. But the Carnegie company had just finished a beam mill large enough to supply the whole demand of the country, and was not satisfied with the allotment given by the pool. This company seems to have been constantly on the alert, when pooling

[1] *Iron Age*, Feb. 11, 1897, reviews the pool's history.

[2] *Ibid.*, Jan. 1, 1901, describes the agreement made.

* In June, 1904, an international pool between the German and English manufacturers was attempted It is too early to determine its effect upon the export trade of the two countries. — ED.

[3] *Iron Age* of Feb. 11, 1897, gives the 1897 allotment thus:

Carnegie	53.50 per cent.
Lackawanna	19.00 " "
Cambria	8.25 " "
Bethlehem	8.25 " "
Maryland	2.75 " "
Pennsylvania	8.25 " "
	100.00 " "

agreements were weakening, to gather in orders at lower figures. Prices fell $22 at once. Boston merchants had a stock of 2500 tons of imported beams left on their hands to dispose of at a loss, and many manufacturers suffered heavily.

An agreement made in 1896 held for a short time, but was broken in the attempt to keep prices stationary in a declining market. Even when the rail pool broke, the beam makers do not seem to have realized that it may be expedient for pools to lower prices as well as to raise them. When the break occurred, in May, 1897, the price of beams fell $12 a ton.[1]

The present pool was formed in 1898 by six leading firms.[2] The agreement since then has been renewed annually. The price has been kept at $1.60 per hundred pounds, Pittsburg, since 1901. Foreign beams came in during 1902–03 on account of the overcrowding of our mills, being able to command a premium by quick delivery. The steadiness of the price of steel beams during 1901–02, as shown by the chart, when billets rose rapidly, is in marked contrast with the fluctuations of 1899, when, as billet prices rose, the beam makers advanced prices with leaps and bounds. This change of policy was partly due to the influence of the Steel corporation. More than any other steel company it must maintain a large volume of business without interruption in order to meet heavy charges. The price of beams in this case was already sufficient to give a reasonable profit. Moreover, a large demand indirectly increased the corporation's profits by reason of its ownership of other subsidiary companies.

The plate pool is a recent development, having existed since 1900 only. The line on the diagram, showing the course of prices of steel plates, is remarkable, inasmuch as it shows a far more violent fluctuation during 1899–1900 than in the case of the other pooled products — rails and beams. In February, 1899, the price of plates was $1.30 per hundred pounds at Pittsburg. Buyers who anticipated high prices bought until in

[1] *Iron Age* of May 20, 1897, describes this pool.

[2] *Ibid.*, Jan. 12, 1902. The firms are the Carnegie Steel Company, Jones & Laughlin's, Cambria Steel Company, Pennsylvania Steel Company, Passaic Iron Works, Pencoyd Iron Works.

August the price had reached $3. As the turning-point was seen, buyers, becoming frightened, withdrew; and the rolling mills fought to secure business, until a price of 95 cents was reached in July, 1900. This ruinous condition was the cause of several meetings, resulting in an agreement between the plate mills in October. Orders came in as soon as the stability of the pool seemed assured, and the year closed with 400,000 tons of orders on hand. Prices were fixed as usual, with a Pittsburg base, freight being added to this base for prices at other points.

An enormous demand for steel plates developed during 1901–1902, due largely to the steel car and steel ship industries. The price was raised to $1.60 in April, 1901, at which it has now stood for three years. The growth of new rivals was checked, and the maintenance of the price during the present slackness was made easier, by the policy of reasonable prices in good times. The pool prevented buyers from competing and pushing up prices in 1901–02, although small mills at one time secured 65 cents excess, for immediate delivery. This excess disappeared in July, 1903, when mills began to close down for lack of orders. The old price was renewed, however, in December.[1] It was thought that the small demand could not be increased by a slight reduction in price. This, however, would seem to be dangerous reasoning, judging by the failures of other pools under similar circumstances.

General conclusions are apt to be misleading on a subject such as this, where full information is carefully withheld; but from the available history of these pools, as outlined, certain facts seem to be fairly well established. It is not possible by law to prevent all price agreements, nor is such a policy desirable. For in such an event, with quick transportation at low rates, competitors are free to fight each other until the more powerful firms drive the weaker ones to the wall. The victors are then free to recoup their losses as quickly as possible at the public expense. Both very low prices and exceptionally high ones are harmful to business in general, and to the public. The manufacturers would seem to be justified in making some

[1] *Journal of Commerce*, Dec. 19, 1903.

agreement, and in allowing one another to continue to share in the business in definite proportions, in order to prevent this destructive warfare.

Two remedial policies are open to competitors in such an event. Either an industrial combination may be effected, or refuge may be sought in one of these price agreements or pools. The railroads were driven to adopt the policy of buying up competitors, — a policy resulting, for a time at least, in embarrassments and receiverships. They have found it necessary to come to some agreement on reasonable and equal rates. The industrial companies, following them some years later, have attempted gigantic consolidations, the result of which is at present doubtful. Most manufacturers would prefer to own their own plants, making whatever arrangements were necessary for continued existence, rather than to lose their identity by selling to a corporation. And direct management by a manufacturing owner may be expected to be more efficient than management by distant financiers representing stockholders.

The second remedy for ruinous competition lies in industrial pools, such as were constantly formed, broken up, and re-formed, until about 1900. This instability seems to have resulted from the fact that no pool or price agreement can continue where the price has not been fixed at a reasonable figure; for new capital is always ready to seek investment where profits are known to be ample. However widely the pool may extend, it cannot absorb all of this idle capital. Only when the pool price is too low unduly to tempt the outsider to build or enlarge his plant is its position at all secure. Another factor of note is that pools are always most favorable to the outside plants, which can enjoy the advantages of the pool price without feeling the restrictions.[1]

Inherent weakness breaks up many, from dissatisfaction with the allotment and the constant temptation to shade the price or

[1] See the Industrial Commission Report, Vol. XIII, p. 492. Mr. Butler says: "I would state as a general law that combinations are always to the advantage of the small concern, . . . that a combination was always to the advantage of the little fellow, whose growth is at the expense of the large concern."

to conceal sales. The pools are in several instances being supplanted by the sliding scale adjustment of prices, based upon the price of the raw material. The effect of the temporary pools is thoroughly bad. Their false profits lead to a misdirected investment of capital, as in the case of the nail pool, where plants sprang up during high prices, so that two months' full operation would have supplied the market for a year. The inevitable price variations are greatly exaggerated, because purchasers refrain from buying when the market is falling, sending prices to the very bottom. Mr. Meade's statement, that the prices which follow the dissolution of a pool are lower than those that brought the producers together,[1] has been frequently illustrated.

These powerful associations exist without supervision of any kind, our knowledge of them being gained chiefly as they fail. Although, since the Trans-Missouri Freight Association, and other anti-combination decisions, all such arrangements have been carried on in secret, it is doubtful if their scope has been appreciably diminished. During the last four years they seem to be on the increase, as a matter of fact. Having been denied recognition by law, they have necessarily devised methods of their own, to preserve their agreement by fines and bribes. Their existence and effectiveness at present would seem to indicate reasonable prices as well as reasonable use of their inherent power in other ways. Experience shows that, were their policy otherwise, the pool would be in danger of breaking suddenly at any time. In any event, a more satisfactory arrangement is certainly desirable. In Germany, pooling agreements have been made enforceable by the courts, and their affairs are subject to government supervision. The evils caused by pools with the "get-rich-quick motive" might, perhaps, in the United States be avoided by a similar legal recognition of the economic justification for associations among independent manufacturers, with agreements both reasonable and enforceable.

WALLACE E. BELCHER.

[1] Trust Finance, p. 28.

V

THE ADDYSTON PIPE COMPANY[1]

THE relevant facts may be classified under the following headings: first, the terms of the trust agreement; second, its purposes; third, its practical construction and operation; fourth, its effects upon the public.

I. Terms of the Agreement

The six companies are located as follows:

Addyston Co.	Cincinnati, Ohio.
Dennis Long & Co.	Louisville, Ky.
South Pittsburg Co.	South Pittsburg, Tenn.
Chattanooga Co.	Chattanooga, Tenn.
Anniston Co.	Anniston, Ala.
Howard Harrison Co.	Bessemer, Ala.

It is to be borne in mind in understanding this agreement that the greater part of the business consists in taking contracts for municipal corporations, gas or water companies, and other large institutions which usually invite bids from various competitors.

The earlier agreement of December 28, 1894, is of present importance only in so far as its provisions have been continued in effect, namely, in respect to the "reserved cities" and to the extent of the "pay territory." The main agreement was proposed by John W. Harrison, President of the Howard Harrison Co., on May 16, 1895, and adopted on May 27, 1895, in the form of a resolution entered upon the minutes of the association. It is as follows (page 83):

[1] From argument of Hon. E. B. Whitney, U S. Assistant Attorney-General, in *U. S.* v. *Addyston Pipe and Steel Co.*, U. S. Circuit Court of Appeals, Sixth Circuit. Appeal Case No. 498. Page references run to the testimony in the official court record.

That from and after the first day of June that all competition on the pipe lettings shall take place among the various pipe shops prior to the said letting. To accomplish this purpose it is proposed that the six competitive shops have a "representative board" located at some central city to whom all inquiries for pipe shall be referred, and said board shall fix the price at which said pipe shall be sold, and bids taken from the respective shops for the privilege of handling the order, and the party securing the order shall have the protection of all the other shops. . . . All division of bonuses to remain as now established during the year 1895.

This system of bidding is known as "buying a job" (page 89).

One exception to the general rule is that of the "reserved cities" which remain tacitly under the resolution of December 28, 1894, as follows (pages 77–78):

Third. The Addyston Pipe and Steel Company shall handle the business of the Gas and Water companies of Cincinnati, Ohio, Covington and Newport, Ky., and pay the bonus hereafter mentioned, and the balance of the parties to this agreement shall bid on such work such reasonable prices as they shall dictate.

Fourth. Dennis Long and Company of Louisville, Ky., shall handle Louisville, Ky., Jeffersonville, Ind., and New Albany, Ind., furnishing all the pipe for Gas and Water works in above named cities.

Fifth. The Anniston Pipe and Foundry Company shall handle Anniston, Ala., and Atlanta, Ga., furnishing all pipe for Gas and Water companies in above named cities.

Sixth. The Chattanooga Foundry and Pipe Works shall handle Chattanooga, Tenn., and New Orleans, La., furnishing all gas and water pipe in the above named cities.

Seventh. The Howard Harrison Iron Company shall handle Bessemer and Birmingham, Ala., and St. Louis, Mo., furnishing all pipe for Gas and Water companies in the above named cities; extra bonus to be put on East St. Louis and Madison, Ill., so as to protect the prices named for St. Louis, Mo.

Eighth. South Pittsburg Pipe Works shall handle Omaha, Neb., on all sizes required by that city during the year of 1895, conferring with the other companies and coöperating with them; thereafter they shall handle the Gas and Water companies of Omaha, Neb., on such sizes as they make.

NOTE. — It is understood that all the shops who are members of this association shall handle the business of the gas and water companies of the cities set apart for them including all sizes of pipe made by them.

A modification was made, however, on December 19, 1895, as follows (page 84):

That upon all inquiries from prices from "reserved cities" for pipe required during the year of 1896, that prices and bonus shall be fixed at a regular or called meeting of the principals.

Another exception recognized was that of "special customers" of the different concerns. As to these it was resolved on May 27, 1895 (page 84):

That when an inquiry is reported to which a member can properly establish a claim as a special customer, such inquiry should not be disposed of by the "auction basis," but shall be handled by such member, the committee fixing the price and bonus, such price and bonus to be commensurate with prices and bonuses at the time such inquiry shall be reported.

It was further resolved on the same day (page 84):

That all parties to this association having quotations out shall notify their customers that the same will be withdrawn by June 1, 1895, if not previously accepted, and upon all business accepted on or after June 1st, bonuses shall be fixed by the committee.

The provisions of this agreement operated only in what was called the "pay territory" or "bonus territory." This territory is described in the pleadings, the opinion of Judge Clark, and the resolution at page 78 of the record. It includes the whole of the United States except Virginia and the States north and east thereof, and except the Territory of Alaska.

The bonuses, when not fixed on the "auction basis," are fixed by a schedule shown on page 78, by such modifications as have since been made therein, or by special order of the committee.

To carry out the objects of the association, headquarters were established at Cincinnati, Ohio, with an office force and a committee of representatives from the various shops (pages 83–84). The bonuses, after December 20, 1895, were divided according to a schedule based on the following estimated tonnage of the various shops (page 86):

	Tons
South Pittsburg	15,000
Anniston	30,000
Chattanooga	40,000
Bessemer	45,000
Louisville	45,000
Cincinnati	45,000

The bonuses were not paid upon the acceptance of the bid or even upon the successful closing of the contract with the purchaser, but only upon the actual shipment of the pipe. Thus the schedule last quoted reads as follows (page 86):

1st. On the first 90,000 tons of pipe *shipped* into "pay territory" 16″ and smaller sizes shall be divided among the six shops [etc.].

In order to insure the proper working of the combination, an auditor's office was established and regular reports required. Thus (pages 80–82):

Third, Sec. 1st. Each shop shall report daily to the auditor all orders secured in bonus or free territory, giving the shop number [etc.].

Sec. 2d. On the 1st and 16th of each month they shall report to the auditor all *shipments* made in all territory, giving shop number [etc.]; showing the amount of bonus and tonnage, of the bonus as well as free territory.

Sec. 4th. The auditor shall make carbon copies daily of all reports received, and send one to each shop, and to such others as may be designated.

* * * * * * * *

Sec. 3d. He shall on the 1st and 16th of each month, or as soon as practicable, send to each shop a statement of all shipments reported in the previous half months, with a balance sheet showing the total amount of the premiums on *shipments*, the division of the same, and a debit credit balance of each company; also a statement of free orders secured during the same period; and a memorandum of balance payable from one to another.

* * * * * * * *

Whoever has a representative at any public letting shall instruct him to send to the auditor a full list of the bids and bidders on same; also that all information in regard to work taken in pay territory by the shops outside of this association shall be reported to the auditor, who shall

keep a proper record of such information and send carbon copies of same to all of the members of this association.

* * * * * * * *

That whenever an order is reported by any shop, and a doubt exists as to the proper bonus to be paid, that it be reported with the facts in the case, to be acted upon at the next meeting of the executive committee.

The combination also kept a "black list" for some boycotting purpose not explained (page 90).

* * * * * * * *

2. Purposes of the Agreement

The agreement of May 27, 1895, contains the following recital of its purpose (pages 82–83):

Whereas, the system now in operation in this association of having a "fixed bonus on the several States" has not in its operation resulted in the *advancement in the prices of pipe* as was anticipated, *except in "reserved cities,"* and some further action is imperatively necessary in order to accomplish *the ends for which this association was formed:* Therefore [etc.]

Mr. Bowron of the South Pittsburg company says that the association was established "to maintain fair prices and a just distribution of work" — "to maintain fair prices and secure for each a fair proportion of the work in a certain territory, by restraining in a certain measure competition as among themselves only" — "to restrain competition as among defendants and allow to each a profitable division of work according to its relative capacity, and thereby maintain fair prices to all" (pages 194–195).

Mr. C. W. Harrison of the same company says that it was "on the theory that destructive competition results in monopoly," and that it "was the purpose of this association to maintain fair prices and secure for each of its members a fair proportion of the work in a certain territory by restraining in a reasonable measure competition as among themselves only" (page 216).

Mr. Callahan of the Louisville company says that it was "to maintain fair prices, to regulate credits, and to accomplish an

equitable distribution of such orders as the six defendants could secure in competition with the other manufacturers of cast iron pipe" — "by regulating to a certain extent the competition among the defendants only, to endeavor to maintain fair prices, and to secure to each of the defendants a fair proportion of the orders in a certain territory" (pages 263–264).

In describing the auction system, Mr. Callahan clearly states what "fair prices" mean as understood by such combinations: "These voluntary offers from defendants were each based upon such prices for the respective orders as these defendants considered would be fair and reasonable prices" (page 264).

That fairness and reasonableness from the consumers' point of view was not at all taken into consideration is shown by the prices actually charged in "pay territory" as set forth in the record, and by a letter of Mr. Thomasson of the Chattanooga company (pages 102–103):

> We believe that as a general thing we have had our prices entirely too high, and especially do we believe this has been the case as to prices in "reserved cities." The prices made at St. Louis and Atlanta are entirely out of all reason, and the result has been and always will be, when high prices are named, to create a bad feeling and an agitation against the "Combination." There is no reason why Atlanta, New Orleans, St. Louis, or Omaha should be made to pay higher prices for their pipe than any other places near them who do not use anything like the amount of pipe and whose trade is not as desirable for many other reasons.

The affidavits of defendants show how in some respects this combination works beneficially by distributing orders in such a manner that a greater regularity of employment is obtained at the different shops. This is immaterial. Probably few unlawful combinations would fail to secure economy of service to some considerable extent. The element of evil does not fail to vitiate the agreement because it contains likewise an element of good. A most interesting letter of Mr. Thomasson (pages 110–112) shows that the bonus system was not intended to work, and did not actually work, simply as a distributor of employment, leaving the price charged to the consumer merely the actual cost with a fair business profit. While some proportion of the bonus may

represent economy in production, a part of it is shown to represent an extra profit divided up among the different companies. Mr. Thomasson points out how the Bessemer company is going too far in speculating on this extra profit, and how his own company is secretly taking advantage of this error of its associate (page 111):

If they should continue to buy all the pipe that goes up to such figures as they have paid for Jacksonville and other points, they would wreck their shop in a few months. However, they of course calculate this bonus *will be returned to them on work taken by other shops.* We are very much pleased with the bonus that has been paid, and we only hope they will keep it up as it is only money in our pockets. . . . We note Mr. Thornton's report of average premiums from June 1 to December that the average was $3.63. The average bonuses that are prevailing to-day are $7 to $8. We cannot expect this to continue. . . . If we cannot secure business in "pay territory" at paying prices, we think we will be able to dispose of our output in "free territory," and of course make some profit on that. At the prices that Howard Harrison people paid for Jacksonville, Des Plaines, and one or two other points, they are losing from $2.50 to $3 per ton, that is, provided "bonuses" would not be returned to them. Therefore when business goes at a loss we are willing that the other shops make it. . . .

P.S. — Do not leave this letter on your desk, where it might fall into the hands of others. Make a memorandum and tear the letter up. Above all things make a confidant of no one in business matters.

I shall comment again later on this letter.

3. Practical Construction and Operation

The record gives some interesting information about the working of this agreement in different cities.

Chicago. — At a meeting of the associates on February 14, 1896, it was decided that an order of the Chicago Gas Company should be filled at $22 and $21.50 with a bonus of $5 (page 88), and (apparently on some other Chicago advertisement, page 89):

On motion of A. F. Callahan, it was agreed on the dates of the Chicago letting at least five of the shops should be represented and a majority of them should decide what bid should be made. The job to be regularly disposed of by the committee before the letting.

The presence of five shops at the letting was in pursuance of the system of "protecting bids," by slightly higher false bids on the part of the companies which had agreed with the combination not genuinely to compete for the order. This system has been consistently maintained by the associates. Its advantages for purposes of concealment are obvious.

Louisville. — The record of December 28, 1895, contains the following (page 85):

F. B. Nichols moved that Dennis Long & Company be *allowed* to close contract for the year of 1896, with the Louisville Water Company at the best price they can obtain for same, and after securing contract refer the same to the meeting of the principals to fix bonus.

Seconded by A. F. Callahan. Carried.

St. Louis. — Mr. Nichols of the Bessemer company writes to the other companies on January 24, 1896, as follows (page 94):

I prefer that if any of you find it necessary to put in a bid without going to St. Louis, please bid not less than $27.00 for the pipe, and $2\frac{3}{4}$ cents per pound for the specials. I would also like to know as to which of you would find it convenient to have a representative at the letting. It will be necessary to have two outside bidders.

St. Louis was a "reserved city" belonging to the Bessemer company (page 77), and paying a bonus of $2 per ton (page 78). The amount shipped from April 1, to December 31, 1895, was 10,970 tons, giving a bonus of about $22,000 to the combination (pages 94–95).

Knoxville. — The Knoxville Woollen mills on April 25, 1896, wrote to Chattanooga and Bessemer for quotations of cast iron pipe (page 62). This contract seems to have been bid in by Chattanooga, which telegraphed the other companies on April 29: "We will advance price Knoxville Woollen mills dollar and half; please protect" (page 96), at the same time bidding $22 per ton (page 63). Bessemer accordingly, through Mr. Nichols, bid $22.24 per ton on April 30, with the hypocritical comment, "Trusting that we will be favored with your order, we are yours truly" (pages 63–64).

Omaha. — The working of the agreement is well shown by the bidding for Omaha on December 20, 1895 (page 87):

W. L. Davis moved to sell the 519 pieces of 20″ pipe for Omaha, Neb., for $23.40 delivered.

Seconded by D. R. P. Dimmick. Carried.

F. B. Nichols moved that Anniston participate in this bonus and the job be sold over the table.

Seconded by W. L. Davis. Carried.

Pursuant to the motion the 519 pieces of 20″ pipe for Omaha was sold to Bessemer at a premium of $8.

The water companies of Omaha belong to South Pittsburg (page 77). The receiver of one of them called for bids in April, 1896, under competitive circumstances which the company's agent evidently thought "will make him some trouble, especially if we try to obtain too high a price" (pages 120–121). In response to a call upon Chattanooga for "protection" Mr. Thomasson wrote as follows on April 28 (page 121):

Please advise us at once as to what figure we shall make on this work. Please do not ask us to make a price of two or three dollars per ton higher than yours, but give us a reasonable price to name.

The Pittsburg company responded (page 122):

We request that you please quote the American Water Works Company of Omaha price of $24.80 per ton of 2000 pounds f. o. b. Omaha.

Accordingly Chattanooga wrote the following candid letter to the Receiver at Omaha (page 122):

Dear Sir: Replying to your favor of the 25th instant, we propose to furnish cast iron pipe as per specifications for $24.80 per ton two thousand pounds, and will furnish special castings from our regular patterns for two and one-fourth cents per pound, all delivered on board cars Omaha, Neb. We are in a position to give you prompt shipment on this pipe *and trust this time we will be favored with your order.*

Very truly, yours,

Chatta. Fdy. & Pipe Works,

By E. B. Thomasson.

Such letters may afford the court some hint as to the amount of weight which can be placed upon the testimony of the gentlemen who manage this honest combination.

Atlanta. — This city was the property of the Anniston company (page 77), which paid a bonus of $2 per ton as the rent of the

property (page 78), until it was provided that such bonuses should be fixed at a meeting of the principals (page 84). On February 15, 1896, the Chattanooga company had an inquiry from the Atlanta Water Works for 1500 feet of 12″ pipe, and about 12,000 feet of pipe varying from 6″ to 10″ with a lot of special castings. The company, through Mr. Thomasson, at once asked Anniston "As to what price you desire us to protect on this contract" (page 97). Anniston answered through Mr. Dimmick (page 97):

Please protect $24 on approximately 375 tons of cast-iron pipe for the city of Atlanta, Ga., on which we are asked to-day for prices. We have sent a man over to Atlanta and will get as much more as possible.

This price was nearly $10 per ton (less cost of transportation) over what would be a paying profit at Chattanooga (page 111). Chattanooga, however, bid $24.50 per ton delivered on board cars at Atlanta, adding with its usual ingenuousness: "We can give you a prompt delivery on above pipe and would be pleased to receive your order" (page 98). A lower bid had been received from R. D. Wood & Co., of Philadelphia, but all bids were rejected by the Atlanta people, as they "were extremely high" (page 98). The bids thus rejected give a good example of the method by which these companies "protected" each other, and incidentally led the consumer to suppose the prices reasonable. They were: Anniston, $24; Bessemer, $24.25; South Pittsburg, $24.25; Chattanooga, $24.50 (page 53).

Anniston at once telegraphed Chattanooga: "Stand pat on your price" (page 99), and in response to complaints about the high price replied: "We believe we made a mistake in trying to get $24 for pipe and $2\frac{1}{2}$ cents for specials, but there would have been no difficulty in this respect had we not run up against R. D. Wood & Co.'s man there putting in his bid for hydrants, and he also put in a bid for the pipe and specials at the last moment;" that "they [the Atlanta authorities] stated it was their belief that the four southern shops have an arrangement by which Anniston is to get the work; in other words, that we had a combination between us, and if they can find it out positively, they will never receive a bid from any of us again;" and recommended that all four southern shops have representatives on the

ground at the next letting on March 4 (pages 99–100). The Anniston company's report from its agent at Atlanta is given in full at pages 100–101. Besides the Philadelphia man he met Mr. Torbett, Secretary of the Water board, Mr. Erwin, one of the Water Commissioners, and Colonel Woodward, Superintendent of the Water Works. He told the city council that "the ruling market price" would be about $24, and got a favorable resolution through the council without a dissenting vote. The Philadelphia man, however, at the last moment put in a bid of $23. The threat against the four southern shops came from Mr. Erwin, and Colonel Woodward also advised the rejection of all bids. The colonel's advice may have been on the ground that "he promised me when there last he would give us another chance in the event we were not the lowest bidders." In other words, he knew that the Anniston company could afford to furnish the pipe at a lower price than what they were passing off as the "ruling market price." It is not surprising that the colonel appears as an affiant on behalf of the Anniston company, maintaining that its prices were "fair, reasonable, and moderate" (pages 200–202), though perhaps it may be surprising that Mr. Erwin fell in line with him (page 202).

Negotiations were opened with the Philadelphia concern to prevent its appearance at the second bidding (page 103). On April 10 (page 59) the contract was made with the Anniston company at $22.75 for the year's supply, and $22 for some "special shipments." Assuming the cost with a fair profit at Anniston to be substantially the same as at Chattanooga, and assuming the freight from Anniston to Atlanta to be $1.60 per ton (page 90), this made a price of about $6.75 per ton over and above a fair and reasonable profit. This seems to be an underestimate, because we find the following entry in the minutes of the Associated Pipe Works for March 13, 1896 (page 90):

> Moved that "bonus" on Anniston's Atlanta Water Works contract be fixed at $7.10, provided freight is $1.60 a ton. Carried.

Before payment was made by the Atlanta Water Works, an investigation was had, based upon charges by the same man whose information led to the present suit. The charges were

referred to a special committee, consisting of Messrs. Erwin and Torbett and one Hass, on May 18, 1896 (page 203). The city's attorneys had advised that the city could recover in a suit against the Anniston Works (pages 207–210). The committee, however, unanimously overruled the attorneys after hearing the officers of the Anniston company (pages 203–210).

4. The Effects upon the Public

It is not essential to show deleterious effects upon the public, but the subject is an interesting one, and the gleams of light from this record are also interesting.

The defendants have repeated *ad nauseam* affidavits tending to show that there were other large works — larger perhaps than their own — in the United States. A tonnage statement, for instance, is given (by an interested witness and annexed to an evasive affidavit) of factories through the country, including some very large ones in Pennsylvania and New Jersey (page 270).

It also appears, however, that the rates of freight are very high. For instance, pipe which is worth from $13 to $14.75 at the shop in Chattanooga (page 111) pays $6 to Peabody, Mass., and $5.55 to Lockhaven, Pa. (page 104); $5.60 to Clifton, N. Y. (page 105), $4.80 to Wytheville, Va., $5.40 to Troy, N. Y., $3.90 to Allegheny, Pa., and $4.95 to Syracuse, N. Y. (page 106). The effect of these high rates, together with the location of these factories on or near the west slope of the Appalachian mountain range, gives to them (and to the few other western works) a practical monopoly of nearly all the "pay territory"— in other words, of everything but the Northern and the Middle states. To this general statement there must be, of course, an exception as to localities on the coast line and elsewhere within the "pay territory" that are within the reach of northeastern factories. The small importance of these exceptions, however, may be gathered from the affidavits submitted by defendants themselves. They have undertaken to show the actual origin of the pipe used in large portions of the "pay territory," and have only succeeded in identifying the great Pennsylvania and New Jersey factories with two small lots of unspecified amount (pages 213, 271). They

content themselves with such evasive statements as those of Mr. Callahan at page 265 of the record, specifying neither the size of the orders nor the portions of the "pay territory" where they are found.

It is clear that as to the bulk of the "pay territory" — that is, as to the bulk of the United States — their competition comes from but few rivals. In main it seems to be confined to the works at Cleveland, Columbus, and Newcomerstown, Ohio, and Detroit, Mich., whose capacity is 200, 100, 75, and 75 tons per day, respectively (pages 197, 250, 181, 188). A concern is indeed mentioned as competing at St. Louis, but it is suspected to be identical with the Bessemer concern (pages 61–62), with which it is almost identical in name. The factories in Colorado and Oregon are small and seem to cut only a local figure. The same may be said of the Texas penitentiary.

Such information as is given us leads to the conclusion that the Ohio and Michigan concerns have the smaller end of the business, even in territory for which transportation rates permit them to compete. Mr. Hallett, a general contractor in Aurora, Ill., gives the precise figures for his purchases in 1895 and 1896. He purchased 514 tons from the combination, 25 tons from the Newcomerstown concern (J. B. Clow & Son), and 50 tons from jobbers (pages 123–124). Mr. W. H. Garrett, of Batavia, Ill., gives the purchases of the Water Works Department of Fairbanks, Morse & Co. for the same period. They included 1023 tons from the combination, 690 tons from Columbus, 79 tons from Cleveland, and 35 tons from the Glamorgan Pipe and Foundry Co. of Lynchburg, Va. These purchases were "in the business of contracting water works for municipalities *throughout the United States*" (pages 129–130).

We could judge more accurately of the strength of the Associated Pipe Works if we were definitely informed as to their capacity *per diem*. They have been so careful to produce testimony as to the *per diem* capacity of other companies (pages 178–179, 180–181, 187–189, 196–198, 198–200, 249–250) that we may infer that there was good reason for their failing to be specific as to their own. The only specific testimony bearing on the point is that of Mr. Llewellyn as to his Chattanooga company. He gives its

capacity at "about 40,000 tons of cast iron pipe and special cast ings annually" (page 243). This figure, however, is evidently taken from the minutes of the combination at page 86, which is shown by Mr. Thomasson of his own company not to represent the actual capacity of the various works, but their usual output (page 111). The 40,000 tons ascribed to Chattanooga represent its proportion of the 220,000 which are assumed, not as the full capacity of the works, but as their probable annual shipments into pay territory. The total of these shipments is estimated at 220,000 for the six companies, but Mr. Thomasson says:

> We think a very conservative estimate of shipments into this territory will amount to fully 200,000 this year; more than that — probably over-run 240,000 tons.

The same estimate which gives Chattanooga 40,000 gives South Pittsburg and Anniston 45,000 combined (page 86); but the officers of these companies join with Mr. Llewellyn himself in verifying the answer (pages 43–44), which contains the following statement as to the "pay territory" (page 36):

> They, however, deny that the shipments of pipe for 1896 amount to more than 100,000 tons in said territory, which they aver could have been supplied by any two of defendants so as to deprive all others of any share thereof.

In ascertaining the actual capacity we may therefore pretty safely double the estimate at page 86, and assume it to be 440,000 tons a year, or nearly 1,500 tons per day, as against the 450 tons per day of their four principal rivals.

As confirmatory of the position that no reliance is to be placed upon the statements of these defendants as to the relative working capacity of the different shops (except when their statements are not made for use in the present suit), we may compare the answer which they all join in verifying with the testimony of their own witnesses concerning the capacity of other works. Thus, the answer states the capacity of Scottdale as 200 tons instead of 100; of Columbus as 150 tons instead of 100; and of Detroit as 100 tons instead of 75 (pages 44, 179, 188, 250).

Another example of the misleading character of this testimony is in the statement of Mr. Callahan at page 265 as to the actual

clearance settlements amounting in 1895 to only 38 cents per ton, when compared with Mr. Thomasson's letter of January 2, 1896, showing that the average premiums from June 1 to December 31, 1895, were $3 63 (page 111).

Besides the partial monopoly which they were enabled to maintain through the high transportation rates and the limited output of their western rivals, they doubtless resorted to special means for diverting rivalry, such as the negotiation for the withdrawal of the Philadelphia company from competition at Atlanta (page 103), and the plan to prevent one Drummond "from invading our western territory" (page 113).

Reasonableness of prices. — It will be borne in mind that, even under the common law doctrine permitting reasonable restraints of trade, the burden of proof as to reasonableness is on the defendant.

"Wherever such contract *stat indifferenter*, and, for aught appears, may be either good or bad, the law presumes it *prima facie* to be bad" (Lord Macclesfield in *Mitchel* v. *Reynolds*, *supra*, at page 701). "In all restraints of trade, where nothing more appears, the law presumes them bad" (id., at page 704). "The general rule is that all restraints of trade which the law so much favors, if nothing more appear, are bad" (Willes, C. J., in *Master of Gunmakers* v. *Fell*, Willes, 388). "Contracts in restraint of trade are in themselves, if nothing more appears to shew them reasonable, bad in the eye of the law" (Tindal, C. J., in *Horner* v. *Graves*, 7 Bing., 735, 744; S. P. Patterson on "Contracts in Restraint of Trade," page 5; *Pierce* v. *Fuller*, 8 Mass., 223; *Chappell* v. *Brockway*, 21 Wend., 157, 159; Addison on "Contracts," page 1154).

We have in this record, however, affirmative evidence of the unreasonableness of the profits obtained by these corporations. Their unreasonableness is shown in various ways, such as by adding the price at the factory (page 111) to the transportation rate (page 90), and comparing this with the prices actually obtained, which usually range from about $22 to $25 per ton. It is also shown by the actual bonuses paid to the combination for the privilege of getting a contract, these bonuses running up to such figures

as $7.10 (page 90), $7.50 (page 88), and $8.00 (page 87) — averaging from $7.00 to $8.00 in January, 1896 (page 111). It is also shown by the large amounts of the aggregate bonuses which were divided up among these companies (pages 116–117). It is confirmed by the statement of the Chattanooga company itself that the prices were "entirely too high," especially in the "reserved cities"; that "the prices made at St. Louis and Atlanta are entirely out of all reason;" and that "there is no reason why Atlanta, New Orleans, St. Louis, or Omaha should be made to pay a higher price for their pipe than other places near them" (page 103). No objection was made to this statement on the score of competency; nor can its competency be doubted (*Wiborg* v. *United States*, 163 U. S. at pages 657–658).

By unduly and vastly raising the normal price of cast iron pipe among communities which, by their geographical position, should have enjoyed special advantages, the combination has the indirect result of increasing competition in the northeastern or "free territory." This is shown by Thomasson's letter (pages 110–112), stating the policy of the Chattanooga company in view of the high bonusus paid by the Bessemer company for southern contracts. He figures out an advantage to the Chattanooga company in refraining from bids and taking its share of the bonus without contributing to the fund, and adds:

> If we cannot secure business in "pay territory" at paying prices, we think we will be able to dispose of our output in "free territory" and of course make some profit on that.

$13.00 to $14.75 per ton is stated in the same letter to be a profitable figure, and the Chattanooga company's propositions to northeastern cities after this letter (pages 104–107) show how the theory is carried into practice by giving those cities an advantage of several dollars per ton in price over the naturally better situated cities immediately adjacent to the works of these defendants. Mr. Llewellyn of Chattanooga, the chairman of the combination and one of its principal witnesses, was thus secretly inimical to its interests.

The letter announcing this scheme is dated January 2, 1896. We are furnished with the balance sheet showing payments and

divisions of bonus for the ensuing four and a half months (page 117). We find that Chattanooga during those months paid in $2016.25, and drew out $15,077.99 — truly a vindication of the wisdom, if not of the candidness, of this valuable witness.

Cast iron pipe, if we may believe Mr. Harrison of South Pittsburg, "has no market value" (page 214). "On account of the manner in which these contracts are let, the customer prevented the establishment of any market price" (page 216). We are therefore without any standard of reasonableness derivable from market quotations. The evidence, however, is overwhelming that in large portions of the country the price is half as much again what it ought to be.

There is, indeed, a large collection of affidavits stating that these prices are reasonable in the opinion of the affiants. Some of the affidavits are by interested parties, more or less discredited as above shown. Most of the rest are by persons who have no real expert knowledge. It will be remembered that cast iron pipe, on account of the peculiarities of its use, and on account of the high transportation rates, has no general market price throughout the country. Each local witness knows only that the combination gives him as low prices as any one else, knowing nothing of the conditions governing the price as it would be if the combination should dissolve.

Moreover the opinions are not accompanied by facts to back them, further than the single fact that the combination is able to underbid its competitors in certain localities. Such unsupported opinions have no weight under the rules governing expert evidence, as set forth in *The Conqueror*, 166 U. S. 110, 130–134, and cases cited.

Conclusion

Enough certainly has been said to show that this secret and hypocritical combination is in violation of the anti-trust law.

If necessary, it could easily be established that it is unlawful also at common law, so that the only question that the Attorney General would have had to consider, had the anti-trust law never been enacted, would have been whether the injury to the public

was sufficient to justify his filing a bill upon general principles of equity, as in the Debs case.

These water pipes and gas pipes belong to the class of arti cles, monopolies in which are especially disfavored by the law. (*Gamewell Fire Alarm Co.* v. *Crane*, 160 Mass., 50, 57.) Every combination tending to prevent competition for public contracts is absolutely void. (*Atcheson* v. *Mallon*, 43 N. Y., 147; *Whalen* v. *Brennan*, 34 Neb., 129, 153.) Combinations to divide up territory, and thereby maintain rates free from influence of competition, are void *per se* at common law, and their validity does not depend upon the result of any inquiry as to the percentage of profits actually obtained. (*Hooker* v. *Vandewater*, 4 Denio, 349; *Stanton* v. *Allen*, 5 Denio, 434; *Salt Co.* v. *Guthrie*, 35 Oh. St., 672; *Craft* v. *McConnoughy*, 79 Ill., 346; *Vulcan Powder Co.* v. *Hercules Powder Co.*, 96 Cal., 510; *Hoffman* v. *Waters*, 11 Weekly Law Bulletin, 358; *More* v. *Bennett*, 140 Ill., 69; *Bishop* v. *American Preservers' Co.*, 157 Ill., 284; *Nester* v. *Continental Brewing Co.*, 161 Pa. St., 473; *Oliver* v. *Gilmore*, 52 Fed. Rep., 562; *Anderson* v. *Jett*, 89 Ky., 375; *Urmston* v. *Whitlegge*, 63 L. T. N. S., 455; *Chapin* v. *Brown*, 83 Ia., 156; *Emery* v. *Ohio Candle Co.*, 47 Oh. St., 320; *Pacific Factor Co.* v. *Adler*, 90 Cal., 110; see also *Hilton* v. *Eckersley*, 6 E. and B., 47; *Ford* v. *Chicago Milk Shippers' Association*, 155 Ill., 166; *Railway Co.* v. *Railway Co.*, 61 Fed. Rep., 993; *Pittsburg Carbon Co.* v. *McMillan*, 119 N. Y., 46; *Santa Clara Co.* v. *Hayes*, 76 Cal., 387.)

Milwaukee Masons' and Builders' Asso. v. *Niezerowski*, 70 N. W. Rep., 166, was decided by the supreme court of Wisconsin on February 2, 1897. Sixty out of seventy or seventy-five mason contractors of Milwaukee made an association, paying into its treasury six per cent on all contracts taken by them, first submitting all bids for work to the association and raising the lowest bid six per cent before submitting it to the owner or architect. This was held an unlawful restraint of trade at common law, without the aid of any statute.

In the famous case of *People* v. *North River Sugar Refining Co.*, 54 Hun, 354, Judge Charles P. Daly, the distinguished counsel for the sugar trust, conceded "that combinations are

unlawful the design and effect of which necessarily is . . . to regulate and control the price of a commodity"; and Judge Barrett, referring to this concession, said that "all the cases, ancient and modern, agree that a combination, the tendency of which is to prevent competition and to control prices, is detrimental to the public, and consequently unlawful" (page 370, note).

It is therefore respectfully submitted that this judgment should be reversed, and a decree entered in favor of the plaintiff.

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VI

THE CAPITALIZATION OF THE INTERNATIONAL MERCANTILE MARINE COMPANY[1]

THE International Mercantile Marine Company completed, on December 31, 1903, its first year of life as a going concern. Up to the date of this writing, if stock quotations are any indication of its financial condition, the success of the company, from a market standpoint, is problematical. Its preferred stock is quoted at 18 and its common stock at 5, prices which indicate a general conviction that the equity in the company is worth little.

There is, however, a possibility that the stock market may be mistaken in its estimate of Mercantile Marine. In a declining market, stock values are influenced more strongly by the financial necessities of holders than by the earning power of the companies whose ownership they represent. This is especially true of the stocks of corporations launched on a declining market where the influence of every adverse factor is exaggerated. International Mercantile Marine has, in this respect, been peculiarly unfortunate. It was brought out during the fall of 1902, when the decline in the market was in full swing, and after the public buying power had been exhausted. Under the circumstances, these securities had no chance of a favorable reception. Moreover, almost from the start they were subject to inside pressure. The English vendors, stimulated by some natural distrust of the unknown economies of combination, and strenuously exhorted thereto by the financial press of Great Britain, which has been

[1] From the *Political Science Quarterly*, Vol. XIX, 1904, pp 50–65. Compare also the same author on Capitalization of the United States Steel Corporation in the *Quarterly Journal of Economics*, Vol. XVI, 1902, pp. 214–232; afterward reprinted in his able Trust Finance.

from the outset hostile to the combination,[1] sold the stock which they received in payment for their interest, and the members of the American underwriting syndicate, as well as the American vendors, hard pressed by the continued stringency in the money market, have contributed to the selling pressure.

The proposition should be considered on its merits, without special reference to the market price of the company's securities.

The outstanding capital of the Mercantile Marine Company is divided as follows:

Underlying bonds	$16,000,000
20-year collateral debenture bonds (4½ per cent)	52,000,000
Preferred stock, cumulative (6 per cent)	54,600,000
Common stock	48,000,000
Total	$170,600,000

To pay interest and preferred dividends — common dividends, at least for some years to come, are hardly to be expected — will require the following amounts:

Interest on underlying bonds, taken at 5 per cent	$ 800,000
Interest on debentures	2,340,000
Dividends on preferred stock	3,276,000
Total	$6,416,000

Following the practice of the older German and English companies and allowing 60 per cent of net earnings for depreciation, insurance, and renewals, the total requirements, letting these funds include the sinking fund, are $16,000,000.[2]

[1] For example, the *Economist* on Nov. 29, 1902, referring to the report that certain English vendors had expressed a desire to receive bonds in lieu of cash, remarked as follows: "They (J. S. Morgan and Co.) also state that the offer was made on the expressed desire of some shareholders, who wished to invest in the bonds. If that be the case, it seems to imply a singular lack of business capacity on the part of the vendor shareholders, since they need not seek far to find securities with a much greater margin of security than these bonds to return a higher rate of interest. All they do know is that its capitalization will be enormously in excess of that of the undertakings that have been absorbed in it, and none should be better aware than themselves of the difficulty that will be met with in earning dividends on such a large sum, since they have had the experience of the same difficulty with a much smaller capitalization."

[2] The bonds of the International Navigation Company, of which $13,686,000 are outstanding, call for a sinking fund of $250,000 to $500,000 annually, beginning May 1, 1905, which will retire the bonds at maturity in 1929. No sinking fund is

Shortly after the Mercantile Marine Company was organized, the statement was made, unofficially, but apparently on good authority, by the Wall Street *Journal*, that the average net earnings of the different fleets for four years were $6,107,675. The same authority stated that the estimated savings in the cost of operation for the year were $10,000,000. Adding these to the average profits above mentioned, the earnings of 1903 should have amounted to a sum sufficient to pay dividends on the preferred stock, although it was not expected that any disbursement would be made. In other words, accepting the corporation's own estimate of the economies which can be secured by its changes in administration, the amount of its earnings falls short of the amount necessary to pay dividends on the common stock.

Before proceeding further in the analysis, let us test the accuracy of this conjectural estimate by comparing these figures with the amount actually earned by other companies during 1902, a year which was more favorable for the shipping industry than 1903. Such a comparison is presented in the following table:

	Tonnage	Net Earnings	Net Earnings per Ton
Cunard Company	114,410	$ 1,235,750	$10.80
North German Lloyd	583,042	4,392,500	7.53
Hamburg-American	651,151	4,458,198	6.85
International Mercantile Marine	1,034,884	16,107,000 (est.)	15.57

It thus appears that the estimated tonnage earnings of the Shipping trust for 1903 are nearly twice the average amount — $8.39 — which was earned during the preceding year by its leading competitors. Moreover, the German companies have for many years operated under a close pool which secures them all of the economies which the Shipping trust was organized to obtain. Unless some other factors shall be discovered by the combination to increase its earnings, these preliminary estimates will eventually require some revision.

provided for the bonds of the International Mercantile Marine Company, but they are subject to call at 105 after five years. If an adequate reserve is provided, the necessity of a sinking fund on bonds secured by shipping property does not appear.

Accepting the same figure of tonnage earnings for the Shipping trust which was attained in 1902 by its competitors, namely $8.39 per ton, we have next to inquire how the combination measures up to its interest and dividend requirements. The net earnings of the company, on this basis, would stand at $8,941,398, leaving $5,801,398 over fixed charges, for depreciation, renewals, and replacements. This amounts to about $5.60 per ton as compared with $4.30 per ton for the Hamburg-American line in 1902, $6.19 for the North German Lloyd, and $8.04 for the Cunard line. If we debit the earnings of the International Mercantile Company with $5.00 per ton for these various necessary expenses, an amount which, considering the age of their fleet and the necessity of providing for the redemption of their bonds, would seem to be no more than is required, and if we assume, as before, their tonnage earnings at $8.39 per ton, the Trust has only $606,978 remaining for its preferred stockholders. That this supposition is not wide of the truth, may be seen from the experience of the North German Lloyd Company in 1902, which earned, over interest, 14,770,000 marks, and credited to renewals and insurance all but 212,477 marks of this amount, reducing their dividend payments from 5,278,131 to 210,623 marks. Taking a three years' average of the earnings of the Cunard, Hamburg-American, and North German Lloyd companies, we find that their combined depreciation and insurance charges amount to $24,719,112 out of $37,976,794 of net earnings, or about 65 per cent. It is impossible to escape the conclusion that the Shipping trust must appropriate a similar proportion of its profits for the service of the company, if the first care of its management is for the property of the company. If this is done, however, a readjustment of the capital of the company is among the probabilities.

We have not reached the end of the chapter. The Shipping trust was organized during a period of great prosperity, when the earnings of ocean transportation, although depressed somewhat below the abnormal figures of 1900, were still large. To pass final judgment upon its financial future, it is necessary that we cast backward and discover, if possible, from the history of other shipping companies, what may be expected if earnings follow the course of former years.

In the accompanying table appears the income account of the Cunard Company for a period of twenty years, including 1883 and 1902.

CUNARD STEAMSHIP LINE

Year	Profits, Including Balance Forward	Reserved for Depreciation	Reserved for Insurance	Total Balance	Dividends	Forward	Insurance Fund Stands at
	£	£	£	£	£	£	£, Often Written lb
1902	263,617	158,722	24,686	68,808	64,000 (4 %)	4,807	357,000
1901	226,022	167,900	5,766	65,984	64,000 (4 %)	1,984	350,000
1900	553,241	284,488	119,037	143,434	128,000 (8 %)	15,434	350,000
1899	294,856	173,223	34,247	83,527	80,000 (5 %)	3,527	260,000
1898	261,691	172,169	29,496	57,663	56,000 (3½ %)	1,663	235,000
1897	222,475	166,938	27,999	41,691	40,000 (2½ %)	1,691	212,000
1896	249,788	184,822	32,417	42,181	40,000 (2½ %)	2,181	202,000
1895	144,305	180,325	. . .	183,731[1]	. . .	deb.int 1,466	187,000
1894	94,953	177,104	. . .	183,020[2]	. . .	2,072	230,000
1893	200,091	154,419	39,966	35,868[3]	32,000 (2 %)	3,868	322,000
1892	174,607	125,856	33,496	36,296[4]	32,000 (2 %)	4,296	317,500
1891	220,991	125,426	38,407	52,382	48,000 (3 %)	4,382	315,000
1890[5]	246,601	125,840	43,144	72,838	64,000 (4 %)	8,838	280,000
1889	350,203	130,573	41,918 54,480	175,469	96,000 (6 %)	4,988	240,000
1888[6]	314,736	135,327 23,000	46,815 40,472	130,172	64,000 (4 %)	2,700	. . .
1887	254,482	135,500	77,839	41,143	40,000 (2½ %)	1,143	Debenture debt re-duced from £450,000 to £96,000
1886	160,910	137,721	23,189	nothing left	nothing left	. . .	Loss of *Oregon* costs £113,241
1885	165,943	141,506	24,437	nothing left	nothing left	. . .	140,000
1884[7]	103,948	87,018 23,000	nothing left	nothing left	. . .	. . .	117,000
1883	146,920	93,134[8]	50,094	. . .	none	1,270	150,094

[1] £39,426 from insurance fund.
[2] £88,067 from insurance fund.
[3] £30,000 from insurance fund.
[4] £25,000 from insurance fund.
[5] The company had on hand at the end of 1890 in investments, bills, and cash, £559,922.
[6] £96,000 debentures paid off July 1st. Balance of cash and investments, £205,804.
[7] £23,000 taken from insurance fund and added to sum reserved for depreciation.
[8] Depreciation fund stands at £302,000.

The feature of the movement which will immediately impress the reader is the extraordinary fluctuations of net earnings. From a minimum of £103,948 in 1884, they rose to a maximum of £350,203 in 1889, an increase of 237 per cent. From that point, although fairly maintained until 1893, they fell in 1894 to £94,953, the smallest figure ever reached. The depression continued during 1895, but in 1896 began the great upward swing which carried earnings up more than 550 per cent, to the enormous total of £553,241 in 1900. From this maximum, the decline was rapid, profits standing at £226,022 in 1901, and £263,617 in 1902. Passing over, for the time being, the explanation of these remarkable fluctuations, let us examine the disposition of profits which this company employed. We note at once that the reserves for depreciation took up a large share: £3,104,011 out of a total of £4,650,380. Another large amount, £787,905, or 16⅔ per cent of the total, went to the insurance fund, which the company has always maintained at a high figure. Out of the surplus remaining, to which was added £182,493 from the insurance fund, bringing the total amount available for distribution up to £940,957, £848,000 was paid in dividends, leaving £93,957 to be carried forward, an amount successively included in the annual profits. In other words, out of £4,650,380 of profits earned in 20 years, the Cunard Company paid out £848,000, or 18.8 per cent to its owners, and kept 81.2 per cent in the business. We note, moreover, that the disbursement of dividends was by no means regular. In six years out of the twenty, nothing was paid on the stock. In five other years, less than 3 per cent was paid, and in only one year, 1900, was as much as 8 per cent distributed to stockholders.

We note also with what extreme care the directors guarded their insurance and depreciation funds, taking every occasion of large earnings to build up these safety deposits, and refusing to sacrifice to the temporary advantage of the owners the permanent welfare of the company. In thirteen years out of the twenty, the profits of the company exceeded £200,000, aggregating £3,658,794. Of this amount only £816,000 was paid in dividends, £2,842,794 being carried to reserve. The shareholders reaped no small benefits, however, from their enforced self-

denial. In four years of the period 1892–95, the insurance fund, which is held in cash and securities, was drawn upon for dividends or to maintain the depreciation fund. Of the £64,000 paid out to stockholders during these four years, £55,000 came from the reserves.

In short, it was only by the most careful economy, by the utmost prudence and conservatism in the distribution of profits, that the Cunard Company was able, over a twenty-year period, to average 2.6 per cent to its stockholders and, during the past ten years, to earn 3.1 per cent on a capital which at no time exceeded the book value of its ships.

For an explanation of the irregularity of these profits, we turn to the nature of the industry. The shipping business is, of all industries, the most irregular. It is liable not merely to the usual alternations of prosperity and depression, but to sudden fluctuations of rates and traffic which are entirely without parallel in any other branch of trade.

To begin with, the industry is strictly competitive. The high seas can never be monopolized. Dockage facilities in the leading countries are open to the ships of all the world, and shipyards will furnish a cargo steamer at a moderate price. Under these conditions, a permanent control of the shipping industry, sufficient to maintain rates or to control traffic, is out of the question. Agreements among the regular lines may introduce a certain degree of stability into passenger rates, and into the freight charges on the higher classes of commodities, but for the great mass of traffic, the raw materials and rough and half-finished products of commerce, carriers and shippers will continue, as they have from time immemorial, to make their individual bargains, and the rates of charge will continue to be fixed by the higgling of the market.

This situation has two consequences. If at any port the supply of shipping waiting for cargoes exceeds the amount of business offered, the competition between owners will force rates down sometimes to the smallest admissible margin above operating expenses. The amount asked by the marginal ship will fix the rate for the time being for all vessels leaving the port. On the other hand, a small excess of tonnage offered will have an

equal effect in raising the rate. Some classes of commodities can be delayed in shipment longer than others, and some vessel owners can afford to lay up a portion of their tonnage rather than accept unremunerative rates. Generally speaking, however, the rule holds good. From every port and on every line of traffic, the rates are constantly changing in a way which would stagger a railway traffic manager, although he was deeply versed in the theory and practice of rebates and special concessions.

For example, take the following table of outward rates on coal from Wales to various ports in 1899:

	s. d.		s. d.	Per Cent of Variation
Port Said	7 9	to	13 6	74
Genoa	7 6	to	11	47
Aden	11 6	to	16 6	43
Bombay	12	to	18 6	54
Colombo	12	to	19	59
Cape Town	19	to	30	58
Rio Janeiro	11 6	to	16	39

The movement of grain rates from the United States, while less irregular than the figures quoted above, is also subject to wide variations.

Examples of more extreme fluctuations are easy to find. The course of rates in the British market in 1896 offers a typical illustration of the extreme instability of ocean rates. The *Economist*, in its annual review of the shipping industry for 1895, reported, at the close of that year: "The tonnage afloat is enormously in excess of the world's requirements, and so long as this continues we cannot see that there will be an improvement." During the early part of 1896, this condition of extreme depression continued. Only in outbound rates to the East, where the China-Japan troubles made a brisk demand for shipping, was any profit presented. These rates advanced, and remained on a high level throughout the year. A large number of ships, finding no profitable employment at home, went out to the East. Once there, however, and the war ended, they could not get back again, for return freights were not to be had, and it was impossible to return such a long distance in ballast without the prospect of remunerative employment. This situation left a large number

of cargo vessels stranded in eastern ports, unable to get back to western waters. A large part of the world's carrying trade was thus locked up. The available supply of shipping was suddenly diminished. The tonnage afloat accessible to English shippers was no longer as in 1895, "enormously in excess of the world's requirements."

Upon a straitened supply was now precipitated an avalanche of orders. Says the *Economist:*

> The corn trade in the past year assumed a novel and unexpected position; the production of the world was slightly short of the consumptive requirements, . . . two of the large producing and exporting countries (India and Australia) being actually converted into considerable importers, and several hitherto small importers making largely increased demands.

The general trade of the country, as the *Economist* notes, maintained the improvement and expansion awakened and started more than twelve months earlier.

> These combined influences came to bear on the freight market almost simultaneously; shippers of nearly every description, all wanting the same thing at the same moment, with a rather short supply of the article; result, blind competition sending up the price of tonnage by leaps and bounds, in many cases 200 to 300 per cent, from the end of September to the end of November. . . . By so much as the rise was rapid, by so much was the decline equally rapid, and at the close of the year we find freights all around, in every trade, worse if anything than at the commencement.[1]

This experience has been repeatedly duplicated in every market. It is true that the total supply of ocean shipping will in time become available to relieve any congestion; but much time must often elapse before relief can be extended, the tonnage must be moved at once, and the ship-owners who are fortunate in being on the spot reap a rich harvest. On the other hand, vessels which have gone out in ballast to Argentine or the United States, expecting full cargoes of grain, or which have made the long voyage to Australia, expecting a large movement of wool, suffer the full effects of a crop failure or a small wool clip.

The following table shows the fluctuations over a ten-year period in four of the leading items in the world's export trade.

[1] Commercial History and Review of 1896. *Economist,* Vol. LV, supplement, p. 25.

Year	Export of Wheat from U. S. Bushels	Per Cent of Change from Previous Year	Export of Cotton from U. S. Bales	Per Cent of Change from Previous Year	Export of Corn from U. S. Bushels	Per Cent of Change from Previous Year	Export of Wheat from Russia Thousand cwt	Per Cent of Change from Previous Year
1892	225,665,812		5,858,000		76,602,285		26,297	
1893	191,912,635	− 15	4,390,000	− 27	47,121,894	− 39	50,351	+ 91
1894	164,283,129	− 14	5,232,000	+ 19	66,489,529	+ 48	65,966	+ 31
1895	144,812,718	− 12	6,726,000	+ 29	28,585,405	− 57	76,453	+ 16
1896	126,443,968	− 12	4,627,000	− 31	101,100,375	+243	70,774	− 6
1897	145,124,972	+ 15	5,979,000	+ 29	178,817,417	+ 77	68,670	− 2
1898	217,306,004	+ 49	7,540,000	+ 26	212,055,543	+ 19	57,047	− 15
1899	222,618,420	+ 2	7,313,000	− 3	177,255,046	− 17	34,466	− 40
1900	186,096,762	− 17	5,946,000	− 19	213,123,412	+ 20	37,627	+ 9
1901	215,990,073	+ 15	6,538,000	+ 9	181,403,473	− 20	44,626	+ 19

Many of these fluctuations took the shipping trade by surprise, and either too few or too many boats were available. In other cases, the supply of shipping the world over was either excessive or redundant, and freights fell or rose to correspond.

So much for the temporary fluctuations of ocean freight rates and tonnage. There are also movements of longer duration, corresponding to the ebb and flow of general business, but subject in peculiar measure to the influence of special forces. From 1893 to 1897, for example, the leading commercial countries were suffering from a commercial depression which caused a general decrease in the tonnage of international trade, and a still greater fall in the value of exports and imports. The effect of this situation upon the shipping industry has been already indicated. Tonnage could not be decreased, and, in fact, the tonnage of the world during these three years increased. The result was an unprecedented depression in the shipping industry. In 1893, the *Economist's* review reports a large number of steamers laid up and a number disposed of at forced sale. In 1894, the report was "low, unprofitable freights and declining values of property engaged; the whole of the enormous trade has brought little or no profit, and a very bare margin over working expenses, far from enough to cover depreciation." In 1895, came a year "which will not readily be forgotten by the ship-owners. . . .

Our anticipations have been to the full realized, and probably a worse year than the present has not been experienced by the very oldest in the business."[1] The condition of the trade, in 1896, as already remarked, was little better.

During the four succeeding years, the situation was entirely changed The widespread industrial revival caused a large increase in the value of foreign trade; and the shipping trade, as illustrated by the rapid and extraordinary rise in the profits of the Cunard Company, became very profitable.[2] The main support of the market, during 1897 and 1898, was the American export trade, which was characterized in the *Economist's* annual review of 1897 as follows:

> It contributed largely toward sustaining rates in the early months, and causing a material advance during the autumn and late summer in all other rates by the ready absorption and continued demand for tonnage of all descriptions from the leviathan 8000 to 20,000 ton cargo boats, to small fruit steamers.[3]

In 1899 the advance continued. General trade, the world over, was active, and the South African war resulted in the largest withdrawal of shipping that had been known for more than a generation. An outbreak of hostilities, involving even a second-rate power, always demands the services of a large amount of shipping. Even the effect of the Greco-Turkish war was sensibly felt; the influence of the China-Japanese war has been already mentioned; and the Spanish-American war materially contributed to the prosperity of the trade in 1898. The shipping industry can, over a period of years, depend with reasonable certainty upon the assistance of several wars. If international disturbances occur during a period of depression, the freight and traffic situation is relieved, and if, as in the case of the Boer war, the outbreak of hostilities comes hard upon the heels of general and abounding prosperity, the result is enormous

[1] *Economist*, Vol. LIV, supplement, p. 26.

[2] The combined exports and imports of the United States, Germany, and Great Britain, in 1895 were valued at $6,323,207,441. In 1901, six years later, their value had risen to $8,635,362,581. A large portion of this increase was undoubtedly due to the rise of prices, but the gain in tonnage was chiefly responsible.

[3] *Economist*, Vol. LVI, supplement, p. 24.

profits for all ship-owners. Not only does war increase the demand for ships, usually on terms highly favorable to the owners, but it raises the level of freight the world over by reducing the supply of tonnage.

These results followed from the South African conflict. At the close of 1900, the British government had withdrawn some 2,000,000 tons of shipping, an amount nearly equal to the total steam tonnage of Germany, and nearly double that of France. In 1900, moreover, the troubles in China required the transportation of large numbers of troops to the East, and throughout the Boer war, a large coal tonnage was kept moving to the Cape. The result, as stated in the *Economist's* annual review, was that

> The tonnage taken on time charter for all trades during the past year has been unprecedented. The rates paid by our Government for transports were 20*s*. per gross register per month, and in some cases more. Many charters in ordinary trades were made for long periods at very remunerative rates. Modern boats have commanded from 7*s*. to 11*s*. 6*d*. per gross ton, according to the trade and length of charter.[1]

In 1901, however, the tide turned. During the preceding four years, the supply of tonnage had been increased 4,049,260 tons, and with the close of the war, the British government rapidly released the ships which it had employed. To make matters worse, the American corn crop was a failure, and the industrial depression on the continent reduced the amount of freight movement. Rates fell 30 per cent throughout the year, and have continued to fall during 1902 and 1903, the close of 1903 finding the trade extremely depressed, with little prospect of early improvement.

We find in this hasty review of the recent history of the shipping trade an explanation of the irregularity of the profits of the Cunard Company, and can understand why the directors have pursued such a niggardly policy in the disbursement of profits. The management of a shipping company lives in constant apprehension. Exposed to increasing competition on every hand; compelled every year to build new and larger boats to keep pace

[1] *Economist*, Vol. LX, supplement, p. 28.

with their rivals; anxiously scanning the commercial horizon for signs of business depression, crop failures, famines, or labor disturbances; hoping and scheming for a few crumbs of subsidy, to introduce a modicum of fixed income into their earnings; engaged in a business as shifting and unstable as the sea on which that business is conducted — is it any wonder that the experienced ship-owners hold fast to their profits and regard the results of a year like 1900 as a gift of Providence to be guarded with zealous care?

Into this peculiar business came the promoters of the International Mercantile Marine Company. Attempting to apply to the shipping industry, the same principles of consolidation and capitalization which had been superficially successful on land, they imposed upon the new corporation an unusually heavy burden of capitalization, and they so arranged the capitalization as to make conservative financial management of the new company very difficult. The purchase price of most of the subsidiary companies was based on the profits of 1900. In the vendors' agreement between the syndicate and the White Star line, for example, it was stated that

> the valuation of the said shares hereunder and under said principal contract shall, subject as hereafter provided, be a sum equal to ten times the net profits of the company of the year 1900, subject to the following exceptions . . . (*a*) a sum for depreciation equal to 6 per cent on the amounts at which the property of the company stood on its books on the first day of January, 1900, and a sum for insurance . . . equal to £3 10*s*. on the same amount . . .[1]

It was further stipulated that the earnings of steamships employed by the British government should "be credited . . . with net earnings of the same amount as were earned or would be earned by similar steamships of the company for the same periods in their ordinary trades."

The year 1900, as has been shown, was one of abnormal profits. The Cunard Company nearly doubled its net earnings, and it is reasonable to suppose that other companies were equally

[1] For the text of these vendors' agreements, see Report of the U. S. Commissioner of Navigation, 1902, Appendix T, pp. 380 *et seq.*

fortunate. A partial record of the prosperity of this year is furnished by the record of dividends. The average dividend of twenty-five leading companies in 1896 was 6 per cent; in 1898, 7.7 per cent; and in 1900, 9.4 per cent. In the extract from the vendors' agreement quoted above, we find a recognition of the fact that the profits of 1900 were exceptional, viz., the provision reducing the earnings of ships employed in the government service to the general average of private employment. This reservation, however, does not go far enough. The mere fact of a large government employment, as has been shown, was sufficient to heavily increase the earnings of ships in private employment, and in capitalizing the earnings of this single year, the promoters of the Shipping trust made a serious mistake.

Indeed, so apparent was the mistake, and so clearly did the trade foresee that reaction was impending, that this fact was openly urged upon the shareholders by the Leyland line as an inducement to fall in with Mr. Morgan's plans. Said Mr. Ellerman, in May, 1901, at the shareholders' meeting of Frederick Leyland and Company:

> The outlook for freights in the near future is, in my judgment, an uncertain one. We have had prosperous times, and I feel that the near future may bring, at all events for a time, a reflux of bad times, particularly when the tonnage which is usually employed in the North Atlantic trade, but which is now employed in government transport work, returns to normal employment; in addition to which a large amount of tonnage is building in America for employment in the Atlantic trade . . .[1]

Not only was the amount of capitalization excessive, but what was more important, the arrangement of the capital of the Shipping trust, taken in connection with the amount of the different issues, was open to serious criticism. In addition to an amount of bonds fully sufficient to absorb the maximum earnings of the company, a liability of $54,600,000 of cumulative preferred stock was assumed, all of whose passed dividends must be paid before the common stock receives anything. Our previous discussion has shown the shipping business to be so irregular that even with

[1] Report of Commissioner of Navigation, 1901, p. 321.

the most moderate capitalization, in some years dividends must be passed, and in other years paid out of reserve. At all times, the directors should have a free hand in determining whether profits shall be distributed to stockholders, used for replacements and depreciation, invested in securities, or held in cash. The irregularity of the business is so great, that a free disposition of profits to stockholders is out of the question. The policy of a well-managed shipping company is dominated by the necessity of reserving from two-thirds to three-fourths of the profits in order that one-fourth may be paid out in dividends. In view of this fact, the absolute amount of the Shipping trust's capitalization is of much less consequence than the nature of the liabilities which it includes. The fact that the company is excessively capitalized is of less consequence than the fact that the arrangement of this capitalization is such as to make prudent financial administration very unpopular with stockholders. In this arrangement, fixed charges and obligatory payments predominate. Of the $170,600,000 of capital, $122,600,000 consist of bonds and cumulative preferred stock. If the debenture interest is passed, while the form of the bonds puts foreclosure proceedings out of the question, the unpaid interest must be discharged before anything is paid on the preferred stock; and if the preferred stockholder is forced to await the convenience of the corporation, the hope of the common stockholder of receiving anything on his investment becomes remote. In other words, a conservative administration of the finances of the shipping consolidation involves a series of postponements, an accumulation of deferred claims. The collection of a reserve sufficient to pay dividends in years of depression, if we may judge from the experience of other companies capitalized on a basis similar to that of International Mercantile Marine, is likely to be seriously interfered with by the importunities of deferred claimants.

It would be going too far to say that the International Mercantile Marine Company is a failure. Its future lies in the hands of the stockholders. If they will sanction a policy of conservatism in the distribution of earnings there is no reason to suppose that the preferred stock of the company may not eventually be raised to the rank of an investment. The unfortunate experience of

the corporation up to the present time, however, emphasizes the fact that it is necessary, in arranging the capitalization of a new company, to take into careful account the conditions of the business in which the new concern is to operate, and in every case to assume that industrial history is to be repeated. The "economies of combination" are no doubt considerable, but they are too problematical to be safely included in an estimate of earnings available for distribution to stockholders.

EDWARD SHERWOOD MEADE.

VII

THE CAPITALIZATION OF PUBLIC-SERVICE CORPORATIONS[1]

EXAMINATION of the statutes and the judicial decisions of our American commonwealths reveals, aside from those cases where no definite policy has ever been entertained, two distinct theories as to the proper basis for capitalization of corporations. One is that the total amount of stock and bonds issued should stand in a definite relation to the actual investment of capital in the enterprise.[2] The other is that capitalization should be based upon earning capacity alone, let the source of such revenue power be what it may, — property, patents, franchises, or mere good will. Under the first policy, an enterprise to be capitalized at $1,000,000 must represent that sum of money paid in at some time, either as cash or an equivalent in tangible property. This is the policy consistently followed in Massachusetts, and somewhat less stringently perhaps in Connecticut.[3] Five years ago a reform in this direction was seriously proposed for New York, although little seems to have been actually accomplished.[4]

The second policy presupposes that, at a market rate of 6 per cent, an earning capacity of $60,000 per year is properly capitalizable at $1,000,000, be the actual investment what it may. The franchise or the good will, it is contended, can be sold for valuable consideration. In the eyes of the law it is property

[1] From the *Quarterly Journal of Economics*, Vol. XV, 1900, pp. 106–137.

[2] For the purposes of this article both stock and bonds are alike classed as capital. Cf. the reasoning in Statistics of Railways in the United States, 1888, p. 13. The inclusion of floating debt is variously viewed in different states.

[3] In Connecticut, until recently, special legislation, especially in the case of street railway corporations, prevailed. For this reason the general laws mean but little, save for those traction companies organized since 1893.

[4] A special committee of the Assembly reported in favor of limiting capitalization to one and one-half times the cost of construction.

during the period of its life at all events.[1] Even in Massachusetts it is considered tangible enough to be attachable for debt.[2] This second policy allows the inclusion of the franchise value — that is to say, the *surplus* earning capacity over a normal return upon the investment — in the nominal capitalization. And the limit of issues of stock and bonds is fixed only by the amount of such actual or estimated earnings, as the case may be. Thus the State Commission in 1899 provided for allowance to the street railway company of Detroit of $8,000,000 for its plant and of $8,500,000 for its franchise, this latter being merely the capitalization of the surplus earnings.[3] Among our American commonwealths the most flagrant examples of unlimited capitalization occur under the laws of West Virginia, Delaware, and New Jersey. In the first of these, no limitation whatever is placed upon stock issues beyond payment of a small registration tax. The Delaware constitution follows the usual statutory enactment of other states, prohibiting all issues of stock except for money paid, labor done, or property actually received. The absence of all administrative control, and the apparent failure of the state courts to rule adversely, naturally renders this law of no effect. New Jersey has met the issue adroitly.[4] Its Corporation Act, as revised in 1896, recites that "nothing but money shall be considered as payment of any part of the capital stock"; except that any corporation may purchase property by the issue of securities, in which case "the judgment of the directors as to the value of the property purchased shall be conclusive." The status of Maine, formerly a refuge for over-capitalized companies, has been recently reversed without modification of its statutes through a decision of its Supreme Court. This has, in effect, held stockholders liable as against a judgment creditor to the

[1] Numerous decisions have established this clearly, among them primarily that of the Monongahela Bridge Company, 148 U. S. 312, and 144 Pa. St. 365, in case of the Mifflin Bridge Company; and recently in *Washburn* v. *National Wall Paper Company*, 81 Fed. Rep. 17.

[2] Public Statutes, chap. 105, 30–38. Cf. the case of Brokaw Brothers, establishing that in private business good will — that is to say, capitalized *future* prospects — is not taxable. *Financial Chronicle*, LXIX (1899), p. 1086.

[3] *Street Railway Journal*, 1899, pp. 477–483.

[4] *The Chicago Banker*, I, 1889, pp. 407–411, gives interesting data on the history of New Jersey legislation.

amount of the balance of the capital stock at par, over and above the value of the tangible property.[1] This decision, based upon the theory that such stock is not yet fully paid up, has already acted as a salutary deterrent in many cases.

The best examples of the effect of the unrestrictive policy is to be found in the industrial combinations organized in the United States during the last few years. Excluding some of the peculiarly speculative ones, thirty-nine of the trusts reporting to the expert of the Industrial Commission indicate that their property owned is worth, even at prevailing high market prices, but 64.42 per cent of their nominal capitalization.[2] It is rare that the preferred stock and bonds do not fully equal the value of the plant, stock, and cash on hand, leaving the huge mass of common stock to represent good will or estimated earning capacity. Under British company law much the same conditions are coming to prevail. Thus the English Sewing Cotton Company's capital is atmospheric to the extent of one-quarter, that of the Cotton and Wool Dyers' Association being more than half fictitious.[3] That similar inflation in the case of our railroads was formerly the rule is equally well known, honorable exception being made of a few companies, such as the Lake Shore, Chicago & Alton, and the Old Colony of Massachusetts.[4] It is probable, however, that in the case of many railroads these abuses have of late been somewhat mitigated.[5] Much of the water has been expunged from the poorer roads through rigid reorganization in periods of depression, such as 1893–98. And, in the case of the stronger ones, the properties have been improved from surplus earnings, so as to fill out their once too generous allotments of capital. This does not seem to be true to an equal degree in England, where over-capitalization of the railroads still seems to be on the increase, owing to their peculiar

[1] *Libby* v. *Tobey*, 19 Atl. Rep. 904.

[2] Bulletin United States Department of Labor, No. 29 (1900), p 671. Cf. the cases of the United States Leather Company and the Federal Steel Company. In both the preferred stock bought the plants, while the remainder went mainly to commissions and promoters' profits. *Bradstreet's*, 1899, pp. 436 and 531.

[3] *Economist* (London), 1900, p. 532.

[4] *Financial Chronicle*, LVII, p 203; LX, p. 352; and LXII, pp. 347 and 480.

[5] Cf. *The Chicago Banker*, V (1900), pp. 335–339.

methods of finance, of which we shall have occasion to speak later.[1]

Two arguments in favor of permission to capitalize earning capacity or future prospects, rather than mere investment, may justly be advanced. One is that in no other way can the risks incident to a novel enterprise, repelling timid capital, be overweighted by possible profits through premiums in the form of securities purchasable at a discount. This argument, however, presupposes risk,—a condition entirely absent from many of the public-service companies, even at the outset of their careers. It also assumes that the persons who take the risk are the ones who ultimately reap the rewards. This, also, is a fallacy in too many cases; since the capital really risked in the plant is often raised on bonds, which receive but a moderate return, keeping them near par at all times; while the speculative profits come to the shareholders who acquire the stock for little or who take it for nothing as a reward for promotion.[2] The second argument has somewhat more force. Mere plant or dead property becomes profitable only through operation. This requires a quick capital in the form of credit or of cash. Without such working capital, the plant not being a "going" concern loses much of its value.[3] Consequently, it is urged, capital in excess of the value of the plant may rightfully be created for this purpose, by the sale of stock or bonds. The importance of this argument in the case of private companies cannot be denied. Recent evidence tends to show that an amount varying from 15 to 175 per cent of the value of the plant is in most of the industrial organizations devoted to working capital.[4] In fact, one of the powerful incentives to the formation of trusts is the desire of the individual producers to be relieved from the strain

[1] Woodlock, in the *Engineering Magazine*, XI, p. 238. Cf. also *Financial Chronicle*, LV (1892), p. 1061, comparing the Pennsylvania Railroad and the Midland.

[2] On the promotion of companies, see a note by the present writer in *Journal of Political Economy*, VIII, p. 535.

[3] This point was covered in the recent Newburyport water-works award, to be discussed *infra*.

[4] Bulletin United States Department of Labor, No. 29 (1900), p. 672. *Bradstreet's*, 1899, p. 739, cites two trusts handicapped from failure to procure sufficient working capital in this way. See also Papers and Proceedings American Economic Association, 1900, p. 150.

of dependence upon the banks for their quick capital. A difference between the public-service company and a private corporation is, however, discoverable in this: that, as a rule, the possession of a valuable franchise, attachable for debt, as we have seen, is sufficient security to enable working capital to be raised by the ordinary means.

The evils incident to allowing a wide divergence in either direction between actual investment and nominal capitalization are quite apparent. Among these, as applied to public-service companies, the most important of course is that all relationship between the charges to the public for service and the net profits upon the real capital concerned is obscured. The actual return upon investment can never be precisely determined without an appraisal of the property. And, inasmuch as such an inventory subverts the primary purpose of over-capitalization, it is a difficult matter to have it authoritatively taken. The case of the Lynn and Boston Street Railway Company, now pending in Massachusetts, is in point. Having been manipulated under exemption from general statutes to a high degree of inflation through successive consolidations, its directorate now bitterly opposes the attempt of the Railroad Commissioners to ascertain the real basis upon which its securities rest. This suggests a second fundamental evil of over-capitalization, the absence of all adequate security, — first, for the creditor, and, secondly, for the shareholders, — especially in any terminable enterprise. As to the first of these, it is obvious that borrowing capacity, while dependent upon current revenue for its interest, must ultimately rest upon the attachable property for final security. And the maintenance intact of this capital — too often taken as synonymous with property — is one of the leading objects of the law regulating limited liability.[1] As for the possible losses of

[1] The inadequacy of the law to prevent dividends paid at the expense of capital, especially in England, is well described in the *Economic Journal*, X (1900), p. 9; and the *Economist*, 1888, p. 407, and 1890, p. 919. Dicksee, Auditing, is also very good. Where the law permits the bonding of an enterprise up to the full amount of the capital stock, security for this indebtedness can only be attained by keeping capitalization well within the value of tangible plant. The stricter Connecticut and Nebraska laws, limiting bonded debt to one-half and two-thirds of the capital stock respectively, would seem, from the creditor's view-point alone, to permit of a greater latitude in this respect.

shareholders in an over-capitalized concern at its dissolution, the danger in most of our public-service companies would seem to be remote. For the franchise grants to the older companies being perpetual, and the growth of population steadily enhancing profits, dissolution can never mean more than a resale at high prices or merger in a succeeding corporation. Only under the newer forms of terminable franchise may such loss probably occur to the shareholders. And it is to be presumed that they will safeguard their interests, or at least should be compelled to do so, by a policy of amortization and of writing off for depreciation.[1]

The rigid policy of Massachusetts respecting its public-service corporations is in large measure an outgrowth of its hereditary policy towards the domestic railroad companies, somewhat halting at first, but afterwards clearly defined by its eminent board of Railroad Commissioners. The corporate evil of railroad stock issued merely as a bonus to stimulate the sale of bonds which are in themselves sufficient to defray all expenses of construction has never been tolerated. Its railroads have, to a greater extent than in any other state, perhaps, been built by sales of stock rather than of bonds, such stock being marketed at a respectable percentage of its face value. The result has inevitably been that, with the assured success of the enterprise, the stock has risen far above par instead merely, as when issued as a bonus to bond purchasers, of rising towards par. The consequence has been that, with prosperous roads like the Boston & Albany, frequent applications arise for right to issue new stock to keep pace with growing value of the plant. And the resultant anti-stock-watering agitation has kept the matter before the public. The focus of attention of late years, however, has shifted to the gas, electric, and street railway companies. The most explicit statement of policy, crystallized into law, is found in the anti-stock-watering laws of 1894 and 1896.[2]

The effect of the conservative policy in Massachusetts appears in the accompanying table representing the capital stock

[1] On the practice of English companies, liable to purchase by the municipalities, see *Economist*, 1898, p. 349.

[2] Acts of 1894, chaps. 350, 450, 452, 472; and of 1896, chap. 473.

and funded debt of various street railway companies. In no type of public-service corporations have the evils of over-capitalization been pushed to greater excess than in the case of this class of corporations. Several causes seem to have cooperated to bring about this result. In almost all our cities, profits dependent upon gratuitous franchise grants have almost in a night become so large as to require concealment. Then again, the progress of the industry has been so rapid since the first electric street road was operated in Richmond, little more than a decade ago, that revolutionary changes in equipment have been necessary. These, in turn, have invited financial manipulation at each turn-over and replacement, just as we know that discoveries of new means of gas manufacture have opened the way to inflation.[1] And, finally, the rapid growth of urban centres has in itself compelled a great extension of track and of service leading to pooling and consolidation, with all their attendant opportunities. We may instance the Chicago street railways as a case in point, with their more than doubled mileage from 1886 to 1896, each mile of track having increased, moreover, in average capitalization from $66,000 to $126,000.[2]

CAPITALIZATION PER MILE OF TRACK, 1899

STOCK AND FUNDED DEBT

(*Street Railway Journal, October, 1899*)

London street railways	$79,632
New York street railways	201,381
New York elevated railways	662,520
Chicago street railways	118,334
Chicago elevated railways	873,231
Berlin street railways	74,708
Brooklyn street railways	119,072
Philadelphia street railways	265,510
Liverpool street railways	94,494
Eastern Massachusetts street railways	61,972
Boston street railways	100,615
Glasgow street railways	54,866
St. Louis street railways	306,644
Cleveland street railways	96,585

[1] *Quarterly Journal of Economics*, XIV (1900), pp. 509–536.

[2] Illinois Bureau of Labor Statistics, 1896, on Franchises and Taxation, p. 48.

(Massachusetts Railroad Commissioners, 1898)

Massachusetts street railways	$46,600
New England street railways	49,500
New York state street railways	177,800
Pennsylvania street railways	128,200
United States street railways	94,100
Great Britain street railways	47,000

(Eleventh Report Statistics of Railways)

United States steam railroads	$60,000
New England states steam railroads	60,000
Middle Atlantic states steam railroads	111,000
Southern states steam railroads	45,000

Scanning this table, the relatively low capitalization of the Massachusetts and New England companies stands forth clearly, especially in contrast with those of New York and Pennsylvania. St. Louis heads the list, with the extreme case of a capitalization averaging five times that of the steam railroads of the United States.[1] Philadelphia and New York are not far behind in this regard.[2] Nor can it be admitted that the service is less efficient in Massachusetts than in either of the other cases. Even for New York state as a whole, with a goodly proportion of suburban roads, which, of course, lower the average, the capitalization is three times that of the steam roads of the country, at large, and 50 per cent greater than that of the railroads in the Middle Atlantic states.[3] It is probable that the average for Massachusetts and New England is somewhat depressed by a relatively greater proportion of purely suburban lines, built at minimum cost. The same factor of low cost also explains in some measure the relatively low capitalization of the European roads. Many are still operated by horse-power or by light electric service, so that comparison with our own country is largely vitiated thereby.

[1] See Report of the Missouri Commissioner of Labor, 1896, for history of this company.

[2] See the extended tables of financial characteristics in the *Street Railway Journal*, October, 1899, pp. 680–684. as also the Report of Special Committee of the New York Assembly upon Municipal Ownership of Railroads, 1896.

[3] Cf. Report of the Massachusetts Committee on Relations between Cities and Towns and Street Railway companies, 1898, p. 37.

That the policy of Massachusetts in attempting to keep capitalization down to actual investment has been fairly successful is attested also by a second table, which compares for Massachusetts the sworn returns of cost with those of capitalization.

COST AND CAPITAL INVESTMENT PER MILE

(*Massachusetts Railroad Commissioners, 1897*)

	CONSTRUCTION.	EQUIPMENT	REAL ESTATE	TOTAL	CAPITAL
Massachusetts, 1887 . . .	$17,600	$8,300	$9,700	$35,600	$32,700
Massachusetts, 1893 . . .	26,800	11,700	15,500	54,000	53,400
Massachusetts, 1896 . . .	23,400	9,800	12,800	46,000	46,400
West End Co, 1896 . . .	$56,600		39,800	96,400	100,700
Worcester Co., 1896 . . .	41,500		6,500	48,000	45,000
Springfield	25,000		8,800	33,500	31,000
Holyoke	23,700		9,400	33,000	31,000

The agreement between the last two columns, for a few companies chosen from a long list, as typical of varying conditions of service, is as close as need be. Discrepancies, where they occur, tend rather to excess of tangible assets over capital liabilities than the reverse.[1] Assuming the maximum cost of a street railway adapted for heavy service, and exclusive of real estate holdings, to be not far from $65,000 per mile, the immense overcapitalization of surface roads in other parts of the country becomes at once apparent.

The regulation of the capitalization of gas and electric light companies in Massachusetts has not been less effective in this direction, dishonorable exception being made lately of the city of Boston. Judging by the latest returns, the majority of the larger companies show a surplus of tangible assets over stock and bonds of from one-third to one-half of their total capital. Thus the Cambridge company, capitalized at $700,000, has a surplus of $358,000; Fall River, capitalized at $450,000, surplus $160,000; Lowell, capital $500,000, surplus $334,000; and

[1] Certain cases occur, as of the West End Company, now leased to the Boston Elevated Railroad. Cf. Report Massachusetts Railroad Commissioners, 1898, pp. 140–155. The first lease proposition was revoked because the capitalization was $26,340,000, while the plant was worth but $25,600,000.

so on.[1] The old Boston Gas Company, capitalized at $2,500,000, actually paid taxes upon $4,129,000, so completely was it swamped by a huge surplus.[2] The aggregate balance sheets of all companies in the state in 1899 showed a total capital of $24,878,000, with a surplus of assets over and above this of $8,115,000, upwards of a million dollars being charged to reserves and depreciation at the same time.[3] In fact, exclusive of Boston, the main problem for the gas companies was as to the proper disposition to be made of these surpluses, as we shall see. The contrast with the situation in New York is adequately illustrated by the facts in that city in 1885, when, with a property worth not over $20,000,000, the Consolidated Gas Company was capitalized at $45,000,000.[4]

Assuming that the conservative policy of strict limitation of capitalization, as exemplified in Massachusetts, is the safer one in the case of public-service corporations, we are at once confronted by a perplexing question: What should be the standard by which the proper volume of stock and bonds is to be measured? A number of possible ones suggest themselves. Among these, we may profitably consider, in turn: first, the total original cost or actual investment from the outset; secondly, the reproduction cost of the plant under present conditions; thirdly, the "structural value," — value, that is to say, for service and wear, irrespective always of earning capacity; and, in the fourth place, market value, or the price obtainable at open sale. To show how widely different these may be, we may cite the leading case of the Interstate Consolidated Railroad Company.[5] Operating both in Rhode Island and Massachusetts, it had obtained a charter from the former state, with the right to issue stock and bonds to the amount of $650,000. It then applied to the Railroad Commission for authority to issue this amount under the

[1] From Investigation of Boston Gas Companies, Committee on Manufactures, March, 1900, tables presented by G. W. Anderson. (Pamphlet.)

[2] *Supplement Annals of American Academy of Political Science*, May, 1900, p. 41.

[3] Fifteenth Report Gas and Electric Light Commissioners, 1900, p. 97.

[4] Report Special Senate Committee to investigate the Supply of Gas in New York, 1885, p. 12.

[5] Report Massachusetts Railroad Commission, 1896, pp. 165–172.

Massachusetts charter as well. The original capitalization of a defunct predecessor had been $875,000, of which only about $470,000 represented the actual investment, the remainder being water. Owing to the fall in prices of electrical equipment, it was established that the plant could be duplicated for about $400,000. Its present structural value was estimated to be not over $255,000, while the price paid for it at public auction by its then present holders was $152,000. Excluding the possible basis of capitalization upon earning capacity, which ranged upon estimate from nothing to $900,000, which of these other standards, between $470,000 and $152,000, ought rightly to be applied? This particular case happened to be simplified by a late change of ownership at forced sale, through which the actual capital invested in the enterprise by the petitioners was known. This being shown, with immediate improvements projected, to amount to $317,197, the board authorized a capitalization of $317,200 in conformity thereto. Had the case, as in ordinary practice, been one of petition for new capitalization by the original company, the decision would have been less easy.

It would seem as if, in an enterprise still in the hands of its projectors, *the original and total cost* might be a fair criterion for capitalization. Such would seem to have been the norm first adopted in Massachusetts. "As the established rule of our law, the capital stock of every business corporation must represent the cash actually contributed by its stockholders,—no more and no less."[1] Or, quoting from a private letter from one of the Railroad commissioners in Connecticut, "The capital in an enterprise is the amount put into it at the time when the enterprise was initiated; although it would cost less to embark in the same undertaking to-day." The latest revision of German company law follows this policy also, in allowing all property to be taken at cost price, minus depreciation, notwithstanding the fact that its actual value is less.[2] There are many valid objections to this rule. The state cannot permit the capitalization of dishonesty, of extravagance, or of incompetence; nor can it permit the burden of obsolete industrial pro-

[1] Report Massachusetts Railroad Commission, 1896, p. 171.

[2] *Economic Journal*, X, p. 13.

cesses or administration to be laid upon future generations. Capital may have been needlessly wasted, as in the case of many Western railroads, through construction companies,[1] or as in the recent scandalous electricalization of the Third Avenue Railroad in New York city. Legitimate expenses of incorporation may be very heavy, as in England; or large expenditures for entirely improper purposes, as in "kissing" bills through legislatures, may have been made. The money may have been actually expended by the promoters, as Jacob Sharp undoubtedly paid many hundred thousand dollars in 1883 for the franchise of the Broadway Surface Railroad Company.[2] This represents real capital invested. Had it been legitimately spent in openly bidding for a franchise, its capitalization might have ensued without question. Or, again, consolidation of various companies, necessary for unity and efficiency of service, may perhaps be attainable only through purchase or control of contributory or supplemental systems. These are to be had only at an exorbitant price. Such, for example, has been the case in most of our large cities, where fancy prices have been paid for local companies; such prices being far above any actual franchise value based upon future earnings. An earnest advocate of street railway interests naïvely observes in extenuation of the admitted fact of over-capitalization that the present high valuation is probably not in excess of the cost of equipment *plus* the cost at the present time of purchasing the rights of way.[3] Such expenditures may be the necessary forerunner of successful operation. Shall a return upon them as capital stock be denied? This cannot be done so long as the criterion of original investment obtains.

These fundamental objections against original investment as

[1] The device of the construction company is still utilized for evasion of strict capitalization laws. Two companies have been privately cited to me in which the actual cost of installation to the construction companies, which were identical in *personnel* with the parent corporation, were $62,000 and $211,000 respectively. The contracts for this work were let, however, at $100,000 and $500,000.

[2] An excellent account is given in *Municipal Affairs*, IV (1900), pp. 139 *et seq.*

[3] *Street Railway Journal*, 1897, p. 212. German company law applies well here in prohibiting the charge to assets of any item above cost price. Thus, if it cost nothing, it must not be allowed to swell the capital account.

a basis for capitalization have led to general acceptance of the *cost of present reproduction* in its place. This is the norm usually accepted by judicial appraisers, as in the recent case, still pending in the courts, concerning purchase by the city in 1895 of the Newburyport water-works.[1] It seems to have been adopted also in appraisal of the Milwaukee street railroads in 1898 as well as in Detroit.[2] It is the one recognized by the Massachusetts Railroad commissioners in their regulation of capitalization.[3] The Gas and Electric Light commissioners in the same state also adhere to it closely in fixing the price of product. This is plainly evidenced in the case of the Brockton Gas Company in 1895. The board ordered a reduction of price, maintaining that the company was justified in earning dividends only upon the cost of duplicating the plant. In the words of the decision, "The profits of companies supplying this kind of public service must compare favorably with those which a new company might need to pay a fair dividend when fully equipped to render the same service."[4] Such is the apparent intention of the laws in most states which make any attempt at regulation of this sort.[5]

It is apparent at once that this substitution of duplication price for original investment shifts the base entirely; inasmuch as prime cost bears no necessary relation whatever to present value, even supposing the investment to have been wisely and properly made. Recent as the trusts are, twenty-four of those reporting to the Industrial Commission state the original cost of their plants to amount to 73.22 per cent of their nominal capitalization, while the cost of reproduction amounted to only 64.42 per cent of the same.[6] The divergence between the two

[1] Bill of Complaint, in case of *Newburyport Water Co.* v. *Newburyport*, United States Circuit Court, District of Massachusetts, No. 924, p. 12. Also raised in the case of Mifflin Bridge Company, Pa. St. 144, p. 36, where, the bridge being swept away while the case was pending, the cost of its duplication became involved.

[2] *Street Railway Journal*, 1898, p 397, and 1899, p. 480.

[3] Cf., for example, the West End Street railway lease in Boston. Massachusetts Railroad Commissioners, 1898, pp. 140–155

[4] Eleventh Annual Report, p. 14, cited by J. H. Gray in *Quarterly Journal of Economics*, XIV, p. 531.

[5] Cf. Bulletin Department of Labor, No. 29 (1900), p 670. [6] *Ibid.*, p. 671.

is, of course, most notable in the case of those businesses in which methods and processes are rapidly changing. The electrical industries, characterized by a rapid fall in the costs of equipment since 1893, will serve as examples. Electric motors, costing perhaps $2850 in 1891, may be replaced to-day in greatly improved type for perhaps one-third of that price. Instances may be cited where the entire cost of a suburban street railway has decreased from $35,500 in 1892 to $22,600 per mile in 1899.[1] Equally great have been the changes in cost of plant to the electric lighting companies, entailing serious problems of regulation of capitalization and of price for the Massachusetts Gas commissioners.[2] The steady fall in the duplication value of these plants has, on the strictest interpretation of the Massachusetts policy, amounted virtually to an impairment of capital, due, however, to no fault on the part of the companies themselves. And it has greatly hampered them in the acquisition of new capital for additions to the plant. The public convenience in the matter of extensions of electric lighting must have suffered severely, had not the companies been allowed greater latitude than the original statutes apparently contemplated in this regard. As a rule, they have been granted time in which, by retrenchment and reduction of dividends, this deficiency may be remedied. On the other hand, the movement of prices oftentimes becomes of advantage to companies desirous of swelling their capitalization. Thus a street railway equipped with steel rails during the industrial depression of 1893–98 at $22 a ton may now find this portion of its property appraisable at upwards of $35 per ton or presently dropping again to the new price for 1900 of $26 per ton. Here is a distinct fluctuation of more than a third in the value of tangible property upon which capitalization may be based, according to the law.[3] Nor does it seem to be possible for the Railroad com-

[1] *Street Railway Journal*, 1898, p. 381, and 1899, p. 402.

[2] See, for example, their Fifteenth Annual Report, 1900, pp. 22, 29, and 32.

[3] The analogy to the case of a trust company whose capital is invested in securities of fluctuating value is close. Cf. the English case of *Verner* v. *General and Commercial Investment Company*, cited in Dicksee, Auditing, p. 467. See also *Economist*, 1900, p. 147, and 1890, p. 1504.

missioners to deny the rightfulness of such a demand. Cases are on record, even, where changes of price between the time of purchase of equipment and of application for issues of stock with which to pay for it have been taken into account, so strictly is the statute interpreted.[1]

Corroborative proof of the strictness of the Massachusetts policy is shown in another way by the table on page 129. Comparing the returns as to tangible assets for Massachusetts as a whole, year by year, a steady increase in valuation is shown from 1887 to 1893, while thereafter an equally noticeable decline is apparent. The cause of this is obvious. The year 1887 marks the early stage of electrical operation, with a low average due to the inclusion of many horse roads and a light electrical equipment at best. Down to 1893 a phenomenal development of electricalization ensued, with high prices, due both to great demand and to costly and cumbrous modes of manufacture. Since 1893 the effects of industrial depression upon prices, the satiation of the demand for electrical transformation, and a notable economy in manufacturing processes have all combined to reduce the expenses of construction and equipment. Note, then, the close correspondence between this phenomenon and the average capitalization, as shown in the last column. The notable decrease is not due to the expulsion of water, but merely to a required conformity of capitalization to value. Such a showing, it is believed, would be impossible under the laws of most of our commonwealths.

Peculiar difficulty is presented in the case of systems transformed from horse to electric motive power. Almost none of the public-service corporations, until recent years, seem to have written off any annual amount for depreciation. Mere maintenance, entirely distinct from depreciation, has generally, though not always, been provided for out of current revenue; but nothing further has been covered. As a result, the suddenly imposed necessity of entirely transforming the old plant into scrap, and

[1] In Connecticut, where greater reliance upon original investment seems to be placed than in Massachusetts, the only case where cost of reproduction is taken into consideration is in case of petition for an issue of bonds, which under the law must never exceed one-half the cost of construction and equipment.

equipping the system anew, offered a great opportunity to the capitalist. To the original capital, now extinct as far as tangible plant is concerned, could be added the entire cost of electricalization. Such was, indeed, the common practice; and much of the flagrant over-capitalization of street railways can be ascribed to this fact. On any theory of original investment as a base of capital, it is at first sight not easy to contest the policy.[1]

The leading case of the so-called "Milwaukee four-cent fare" decision raised this issue.[2] The constitutionality of an ordinance reducing fares from five to four cents was in question, under the Fourteenth Amendment to the Constitution, and the court was called upon to decide as to the real value of the plant of the street railway company, irrespective of its fictitious capitalization of $15,000,000. Counsel for the city contended that the cost of reproduction at present prices, not the original investment, should be considered as a dividend base. To this objection was properly made that to disallow all costs of original installation, forcing thereby capital to attend upon industrial and price stability, would be to put a severe penalty upon enterprise. And in this particular case, to the reproduction value of the plant of $5,000,000 was allowed an addition of $2,000,000 for "costs of pioneering." Adding to this the capitalization of the *surplus* earnings as a measure of the purchase value, decision was rendered that a four-cent fare yielded an inadequate return; and the ordinance thereupon was set aside.

The practical rule of appraisal generally adopted is, as we have said, to estimate the value according to cost of reproduction. From this, however, in order to determine the *structural value*,—that is to say, the "fair value for the purposes of its use,"—an allowance for depreciation must be made.[3] This

[1] Cf. Report of Bureau of Labor Statistics, Illinois, 1896, p. 54, on Chicago experience; as also New York Report on Municipal Ownership of Railroads, 1896, pp. 1851 and 1865.

[2] *Street Railway Journal*, 1898, p. 397. Cf. also *Municipal Affairs*, IV (1900), p. 212.

[3] Consult E. Mathieson, The Depreciation of Factories, third edition, London, 1893; and L. R. Dicksee, Auditing, third edition, London. The Massachusetts Municipal Ownership Act requires depreciation to be charged off at 5 per cent annually.

must be sharply distinguished from allowance for expenses of maintenance, — a distinction often lost sight of in practice. Depreciation is entirely different from loss through "wear and tear." No matter how thoroughly in repair a plant may be kept, under modern industrial conditions it is bound to require entire reconstruction within a calculable time. This time may vary from a very few years in the case of gas retorts, through ten or a dozen for street railway road-bed, and up to fifty years for buildings and permanent structures. The necessity of ultimate reconstruction or replacement is the same in any case.

The English courts have never recognized the economic law that capital must ultimately be replaced from profits.[1] Not until 1878 was the principle recognized in the assessment of the English income tax. Prior to that time the only deduction from gross income allowed was the average actual expenditure for repairs. A test case then showed the necessity of an additional "just and reasonable deduction" for depreciation. The gas companies in this country seem to have had the facts of depreciation, as distinct from maintenance expenses, impressed upon them by long experience; although in Massachusetts a plethora of reserve funds has been the rule by reason of the strict regulation of stock issues. From the statements of twelve of the largest gas-works in the United States, the charge to depreciation far outweighs that for maintenance and repairs.[2] On the other hand, it may be stated with certainty that until 1895 almost none of the electric surface roads set off any proportion of profits for this purpose.[3] The necessity for such a charge to "deferred operating expenses" formed an interesting element in the Milwaukee four-cent fare decision above men-

[1] Cf. article Capital in Palgrave's Dictionary of Political Economy. Many additional cases will be found in Dicksee's Auditing.

[2] Fourteenth Report United States Department of Labor, 1899, p. 387. Cf. the excellent paper on Depreciation in Gas Works, by H. S. Chase, in *The Public Accountant*, Philadelphia, 1900. (Reprint.)

[3] Ninth Report Bureau of Labor, Illinois, 1896, p. 56; and *Street Railway Journal*, 1899, p. 403. Consult How to determine the True Net Earning Power of Street Railway Properties in *Street Railway Journal*, XVI (1900), pp. 246–250, for an adequate discussion of this. As also on reserve and suspense accounts in *Ibid.*, 1898, p. 796.

tioned.[1] It appeared that the company until 1896 had made no deduction from gross income for depreciation of the plant. The city, therefore, seeking to establish the fact of exorbitant earnings at the former five-cent rate, sought to compel estimation of these net earnings strictly according to the company's books. The court, however, was constrained to admit the patent fact of depreciation, despite the absence of any writing-off for this purpose by the company; and it was allowed that operating expenses ought really to have been a quarter more than they had been made to appear.[2] Since this time the almost universal foreign practice of creating a special depreciation fund or of carrying reserve or suspense accounts, has been generally adopted.

It is difficult to excuse this haphazard sort of finance on the part of American street railways. Even in Massachusetts they have gone bravely on, reporting a steady decrease in the proportion of operating expenses to gross income, — from upwards of 81 per cent in 1888 to 68.2 per cent in 1899.[3] With sounder financial methods, this proportion of operating expenses to gross income, perhaps, ought to be now appreciably higher. Failure in earlier days to reckon with this factor is probably due to imitation of the financial methods of the steam roads. So long have these been in operation that American experience has accurately distributed the proper annual expenditure for repairs, maintenance, and reconstruction, necessary to perpetuate the plant in full efficiency upon a cost of reproduction basis. On European roads the accounts are differently kept. Betterment through reconstruction is more commonly charged to fresh capital account rather than to current operating expenses. Yet the practice of keeping distinct accounts with depreciation is said to be general.

[1] *Supra*, p. 123.

[2] The Milwaukee company's accounts are now models in this respect. *Street Railway Journal*, 1899, pp. 351 and 369. The experience of the West End railway (Boston) is a case in point. Within six years after the installation of an entirely new nine thousand horse-power electric plant, the entire station was remodelled at an expense of $500,000, merely to substitute direct driving engines for power transmission by belts.

[3] Report Massachusetts Railroad Commission, 1900, p. 75. Cf. *Street Railway Journal*, 1897, p. 214, commenting upon this.

Thus far we have spoken of depreciation as applied to deterioration or supersession of physical plant. Depreciation, or rather perhaps amortization, as it might more properly be called, due to a limited franchise life, is of a different sort. The Massachusetts policy, however, not permitting the capitalization to include any franchise valuation, avoids this difficulty altogether.

We may dismiss the final criterion of capitalization, according to *market value*, with a few words. In the first place, such market price bears no relation to the value of the plant "for the purposes of its use," so long as it is in successful operation. And, even in those cases where subsequent sale may have been contemplated, such a sale, in absence of a continuous open market, might take place at an absurdly low figure under pressure. Thus the Massachusetts Railroad commissioners refused in the case of the Interstate Railroad Company, above mentioned, to consider the auction price as any fair criterion even of structural value. And, on the other hand, such market price, if it be computed upon the price of securities, can never make distinction between the value of the plant and the worth of the franchise. This, in Massachusetts at least, where no value in the franchise is ever allowed to enter into capitalization, means that the franchise rights merely enhance the market price of the existing issues based upon real property. To allow this market price of securities to enter, even remotely, into any calculation of property value, would obviously be to overset the restrictive policy entirely.

The problem of legally restricting the capitalization of an old-established corporation is essentially different from that of controlling the organization of a new one. In order to elucidate this, we must consider separately some of the means by which the volume of corporate securities is increased during the life of the companies. Probably the commonest of these is by the payment to shareholders of so-called stock dividends. These consist either of an outright bonus of new shares of stock or bonds; or, in a mitigated form, as stock sold below par or at less than market quotations. Such "melon-cutting," in the parlance of Wall street, may range as high as 100 per cent, as in the Adams Express Company dividend of 1898. The notable

Boston & Albany distribution of state stock in 1882 is a familiar example. This crudest form of inflation of capital, whether up to or beyond the increasing value of the plant, is the easiest to control directly. And statutory prohibition of the issuance of stock at other than a price fixed at public sale would seem to be easily enforceable.

Another somewhat more subtle mode of accommodation of capitalization to enhanced revenue potential, since it may not really augment the volume of securities outstanding, is to substitute stock issues for funded debt. The tendency in this direction seems to be very marked at the present time among the strongest of the American railroads, such as the New York Central, the Pennsylvania, the Central of New Jersey, New York, New Haven & Hartford, and others [1] In some of these, outside of Massachusetts, the primary motive would seem to be to take advantage of rights to issue securities at par, where market value is high. But in addition there would seem to be the advantage of great elasticity in future dividend possibilities, within the same limits of total capitalization. Thus a substitution of possible 8 per cent stock for present 4 per cent bonds clearly permits of the absorption of greater earnings to be derived in future. The advantages of stock issues over bonds in the way of elasticity downward, is, of course, always to be added; as they permit of a cessation of dividend burdens during periods of depression. Probably for this reason the tendency of most reorganization schemes seems to have been in the direction of retirement of bonds in favor of stocks. This mode of substitution is, however, clearly confined to those companies whose finances are in such excellent condition that their stocks will sell above par. To substitute stocks, which can only be placed on the market at ruinous discounts from par value, for bonds, — which, being well secured legally, are quoted much higher, — would seem to be bad finance. Ability to increase capitalization by stock issues to advantage may in general be taken as evidence of prosperity. The only efficient safeguard for public

[1] Cf. *Bradstreet's*, XIX, p. 356, and XXI, p. 163. The Delaware & Hudson controversy is interesting in this connection: *Ibid.*, XXII, p. 227. Cf., also, *Ibid.*, XV, p. 534, on reorganizations.

interests in such cases would seem to be through the right of approval exercised by an able administrative commission, where consent should be required prior to all such substitutions.

The gradual accumulation of a surplus, either by good management or by exceptional opportunities, followed by a petition for its capitalization into stocks or bonds, constitutes one of the most troublesome problems in any attempt at strict regulation. For, as will readily be observed, in so far as such a surplus — either in the form of cash, of securities of other companies, or of additions to the original plant — represents augmented investment, it would seem to offer a proper basis for addition to capitalization. It cannot be denied that in this case the property has enhanced in value. Unfortunately for the company, however, a surplus stands too often in the public eye as witness to abnormal and undeserved earnings in the past. In those commonwealths which once provided in their early railroad charters for escheat to the state of all earnings in excess of a certain amount, usually 10 per cent; or those, like Massachusetts, which under the recent law of 1898 provide for a special tax upon dividends of street railways in excess of 8 per cent, such a surplus may denote an actual evasion of legal liabilities.[1] To permit such deductions from dividends in earlier years to be capitalized at a later date would seem to be, indeed, a flagrant subversion of public policy. On the other hand, in many cases the surplus may not represent undeserved earnings or concealed profits. It may be due to enhanced values in right of way, or in investments, whether of real estate or in securities of other companies; thus in no wise indicating an excessive burden upon the consuming public. Even more difficult of just determination, such surplus may be entirely due to exceptionably able business management by which, even with low rates to the public, economy has come to its deserved fruition. To deny the right to capitalize such accumulated earnings is to penalize enterprise and to discourage economy; neither of which, certainly, is consonant with wise public policy.

As illustrative of the difficulties presented by the above-

[1] The pending suit of the state of New Hampshire against the Manchester & Lawrence railroad is a case in point.

described situation, we may instance the recent case of the Haverhill Gas Company in Massachusetts. The capitalization of this company — originally, in 1871, fixed at $75,000 — was not increased through years of prosperity, until a surplus amounting to nearly $300,000 had been accumulated. This existed, not as cash or securities, but in the form of plant; that is, in new buildings, enlarged retorts and reservoirs, extensions of mains, and the like. The surplus, moreover, far from being the result of extortionate rates for gas, was largely due to exceptional management. This point must be strongly emphasized; for it constitutes the novel element in the case. For years the rate of $1 or $1.10 per thousand cubic feet had prevailed, — a rate recently obtainable only in the metropolitan centre of Boston, and appreciably below that customary in other neighboring cities of equal size. The situation was complicated by the attempt of certain foreign capitalists to water its stock through a lease to a finance company. With this phase of the matter we shall have to do later. For the moment we have to discuss merely the justice of allowing the company directly to realize some return upon these accumulated earnings, through an increase of its capitalization, up to the structural value of the plant. The Gas commissioners ordered the price of gas reduced to 80 cents, upon petition of the mayor and others, who asked that it be fixed at 70 cents. This figure, it was estimated, would enable the company to pay 8 per cent dividends upon its original capital, carrying nothing further to surplus. Similar standards, according to the showing of the petitioners for reduction, would give prices per thousand in other cities as follows: Cambridge, $1.02; Fall River, 94 cents; Lowell, 87 cents; Springfield, $1.08; and Worcester, 91 cents.[1] All of these, as will be noted, are very much above the Haverhill rate.

The argument of the advocate of restriction is to the effect that, even granting the surplus to be a reward of economy and efficient management, and not of extortion, this surplus belongs to the public. It should be regarded merely as a deferred dividend, which reaches the people in instalments, through the low

[1] Investigation of Boston Gas Companies Committee on Manufactures, March, 1900, tables presented by G. W. Anderson, p. 10. (Pamphlet.)

price of gas which the greatly improved plant makes possible; in other words, that municipal ownership of the plant has really ensued, leaving it to be operated, however, by a private company for the fixed rental of 8 per cent. To this contention, answer is made that the argument fails, both theoretically and practically. From the former point of view alone, it is defective, in that it strikes at the root of all enterprise. It confounds this present case with those in which the surplus is a result of exorbitant charges or of deficient service. Its effect would inevitably be to give support to mediocrity of management alone. It is absolutely at variance with the theory that profits form no part of price. For although no direct condition of competition of plants may exist, there being municipal monopoly; yet, the purview of the public being made state-wide through public reports, competitive price conditions prevail, nevertheless. All reward beyond the normal return upon investment being denied to extraordinary economy and ability, no incentive to improvement of service would longer exist. Such extensions and improvements must, however, continually be made in the interest of the public. And herein the practical weakness of too restrictive a programme appears. Denied the incentive to accumulation of surplus through economy, — that is to say, discouraged from making additions to the plant necessary for improved service out of operating expenses, — the way is always open to acquire new capital for the same purpose, by an increased issue of stock or bonds. Is it not better that this new capital should be produced from within, allowing the company some participation in the profits through a moderate capitalization of its surplus, rather than that all expenditure for improvement should come from without, thereby saddling upon the consumers the additional interest or dividend charges? A tardy recognition of the cogency of this argument would seem to appear in the refusal of the Commission to order a reduction of the price of gas in Lynn to a strictly minimum profits level.[1] Whether similar reasoning in the parallel Haverhill case would have been followed, could the infamous stock-jobbing element have been eliminated, must remain in doubt.

[1] Decision rendered May 15, 1900. House Document No. 1351.

Next in importance to the conversion of a surplus into stock as a means of increasing capitalization is the expedient of funding contingent liabilities or a floating debt. These may exist in any of their common forms, as loans, bills payable, credited vouchers and accounts, wages and salaries due, or even in the mixed status of receiver's certificates. Such debts are generally indicative of reckless financiering. They may sometimes be necessary to the conduct of a growing business. Nevertheless, an abnormally large proportion of current liabilities, as a rule, is an unfavorable symptom. It implies, as in the familiar examples of the Erie and the Union Pacific railroads, an inability to raise additional capital as needed, by the sale of bonds. Such a condition is usually the accompaniment of a deficiency of current income, whereby maintenance has to be met in part by a charge to capital account; or, as in the sudden appearance of a gigantic floating debt of $12,000,000 in the case of the Third Avenue railroad in New York city, it may be a result of corruption or political "bleeding." But, on the other hand, the creation of such a floating debt may sometimes serve as a means to the enlargement of capitalization. This would seem to have been the case of late with public-service corporations in Massachusetts, particularly the electric light and power companies. Denied the expedient of surplus conversion into stock, both by the public policy already discussed and by the great depreciation in the cost of equipment, recourse has most naturally been made to the opposite expedient. Almost ten years ago [1] the Gas commissioners called attention to the desire on the part of companies managed by "men of a speculative turn of mind" to cover all expenditure for construction by issues of interest-bearing scrip. A striking example of such financiering occurred in 1894, in the attempt of the Boston Electric Light Company to fund some $240,000 of floating indebtedness.[2] It appeared that the tangible assets were not equal to the capitalization, presumably because too large a proportion of earnings had been distributed as dividends, leaving too little for maintenance of the plant and writing off for depreciation. "Floating debt, representing the

[1] Sixth Annual Report, 1901, p 34.
[2] Tenth Annual Report of the Gas Commission, 1895, p. 42.

cost of new plant needed to take the place of that which had been worn out and useless, is essentially a part of the expense of carrying on the business, and should be provided for, if possible, out of the earnings Capital stock has no claims upon the earnings precedent to those of creditors, and not to be governed by this fact is to endanger the well-being of the stock itself."[1] Oversight of the finances of each company year by year, especially in this matter of the proportion of current income applied to betterment, particularly in a field where falling costs of reproduction prevail, seems to be an essential part of any effective scheme.[2]

The consolidation of companies offers a convenient mode of surreptitiously adding to capitalization. This may take place in any one of three ways. In the first place, the merger may lead to reconstruction or replacement of operating plant, with its attendant devices of betterment entirely defrayed by means of new stock issues. This has already been described. Less common is the second method. This consists in gerrymandering the constituent companies, so that those strong ones oppressed with surplus earnings may have aggregated about them the roads which are less favorably situated. The claim is openly made[3] that the Massachusetts Electric Companies, composed of forty odd suburban traction lines, is having its membership so distributed in three main groups, each to be separately operated, as to effect this end. Thus the Lynn and Boston road, earning perhaps twice its legally allowed dividend of 8 per cent, is made to average up its earnings with a number of small roads which are scarcely meeting operating expenses. The result is a 6 per cent dividend upon their united capital, with a net yield to shareholders far in excess of that contemplated under the law of 1898. The third stock-watering device attendant upon consolidation consists merely in the substitution of a high-grade for a low-grade security. For example, a weak company, whose

[1] Similar and more recent cases occurred in Malden and Waltham respectively. Fifteenth Annual Report Gas commissioners, 1900, pp. 22 and 39

[2] A case has been privately cited to me, where a street railway company, wishing to make a favorable exhibit of earnings, tore up its recently laid rails, providing for new ones by issue of stock; and then credited the large proceeds from sale of old equipment to current revenue.

[3] Street Railway Items, Boston, Oct. 1, 1900.

stock is quoted at 50, is merged in a second operating corporation, with stock, bid, we will say, at 200. This latter company issues new stock worth $200, share for share, in exchange for the $50 stock, which is thereupon cancelled. The legality of such operations under Massachusetts law is open to question. But they would seem to have been not infrequently undertaken in recent years.

The final method of evasion of anti-stock-watering statutes is found in the creation of independent finance corporations, to which the operating company may be leased, sold, or trusteed. The practice may best be made clear by a few examples. In 1893 the Brooklyn City Railroad Company, operating with horse-power, was capitalized at $6,000,000. At that time its power was transformed to electricity; and, as has been customary in such cases, the opportunity was seized for an increase of stock and bonds to $18,000,000. Simultaneously the road was leased to the Brooklyn Heights Railroad Company, a tiny corporation operating only a mile of track and capitalized at $200,000. This company agreed to meet interest charges upon $6,000,000 of bonds and to pay 10 per cent upon the $12,000,000 of stock of the leased company. Finally, in the same year, the Long Island Traction Company, incorporated under the laws of West Virginia with $30,000,000 capital, purchased the stock of the intermediary, — the Brooklyn Heights Company, — in order to absorb such surplus revenue as might remain over and above its obligations to the primary and sole operating concern. Thus was a fivefold increase of capitalization up to the desired figure finally effected.[1]

The creation of such finance companies has not until recently occasioned much difficulty under the strict prohibitions of Massachusetts law. The Light, Heat, and Power corporation, organized under the laws of West Virginia, has been attempting since 1898 to operate the electric plants in Milford and Clinton, for example.[2] It would seem, however, that — legal quibbles aside — a clear case of violation of the statutes could be estab-

[1] From letter of Judge Gaynor of the Supreme Court, reprinted in Report of the Committee upon Municipal Ownership of Railroads (Albany, 1896), II, p. 1604.

[2] Report Massachusetts Gas and Electric Light commissioners, 1900, p. 33.

lished. Far more serious is the expedient adopted by the Haverhill Gas Securities Company.[1] This finance concern, by incorporating under the laws of Massachusetts, evaded the provisions of the law of 1894, which declared invalid alone all leases of a domestic to a *foreign* corporation. The new company issued stock to the amount of $500,000, in payment to the owners of the gas company for their original capital of $75,000 and their accumulated surplus of about $300,000. The money necessary for formal compliance with the Massachusetts law requiring all stock issues to be paid up in full was temporarily advanced by the promoters, and paid over to the owners of the gas company in exchange for their property. The next step was to issue and sell 5 per cent debentures to the amount of $500,000 to recoup themselves for their advance, depositing the original stock of the gas-light company with a trustee as collateral. Thus the bondholders of the Securities Company virtually paid for the gas works; while the control of its business remained in the promoters' hands, they retaining the Securities Company's stock of $500,000 as their share of the proceeds. As a net result, then, we find the capitalization of the operating plant, upon which the public are to pay charges, advanced from $75,000 to $1,000,000. Only two remedies were open. One was to annul the charter of the finance company; the other was to reduce the price of gas. This latter course was the one adopted by the Commission, as we have seen, they recommending, also, that the legislature dissolve the company's corporate existence.

Still a third similar mode of evasion, in addition to leases to foreign or domestic finance companies, is being tried in Massachusetts. This is to avoid the corporation laws altogether, by leasing the operating companies to mere business associations. These are, in practice, nothing more nor less than partnerships, with all the provisions of unlimited liability in force. In this respect they closely resemble the New England Gas and Coke Company,[2] or the real estate trusts, of which there are several

[1] Report Massachusetts Gas and Electric Light Commissioners, 1900, p. 6.

[2] See the excellent history of this organization in the *Quarterly Journal of Economics*, XIV, 1899, pp. 92–120.

in Boston. The leading example of these in the field of quasi-public corporations is the Massachusetts Electric Companies. This association now controls what were originally some forty distinct street railroad companies, forming an unbroken network throughout the eastern quarter of the state. These operating companies have an aggregate stock capitalization of about $9,000,000.[1] They seem to be slowly consolidating, it is said[2] with the end in view of merger in a single corporation, to be known as the Massachusetts Electric Company. The $10,000,000 of stock of this consolidation will then be entirely owned by the Massachusetts Electric Companies' Association, represented by securities outstanding to the amount of $24,000,000. The legal status of this latter organization is as yet undetermined by the courts. In any event, a prompt extension of the provisions of the anti-stock-watering acts to cover all such associations would surely act as a powerful deterrent in future.

Enough has been said to illustrate the extreme complexity of the problem of regulating capitalization, even in the limited class of public-service companies. The ultimate remedy, as applied to all classes of corporations, must come from the courts and the legislatures. But in either case the continued necessity of a strong and steady administrative control through some permanent board or commission, supplementing and giving due effect to the law, is apparent. Massachusetts has not, perhaps, accomplished all that could be desired as yet either in justice to the companies or to the public; but her experience should be of great value, in view of the honest purpose which seems to have inspired it throughout.

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[1] The bonded indebtedness, amounting to approximately $10,000,000 (?), remains outside the control of the association, largely in the hands of the original purchasers.

[2] Street Railway Items, Sept. 15, 1900.

VIII

THE UNITED STATES STEEL CORPORATION'S BOND CONVERSION[1]

ON April 17, 1902, the president of the United States Steel Corporation issued a circular to the stockholders, which invited their cooperation in a plan to raise $50,000,000 of new capital. Half of this amount was to repay loans incurred by the constituent companies for construction work which was in part rendered unnecessary by the merger, but which, owing to advance commitments, could not be suspended. In addition, $25,000,000 was required for improvements, which, it was stated, would effect an annual saving of at least $10,000,000. The plan proposed to the stockholders for raising this money was "to rearrange your corporation's capitalization (which, in round numbers, now consists of $300,000,000 of bonds, $500,000,000 of preferred stock, and $500,000,000 of common stock) by substituting for $200,000,000 of the preferred stock, $200,000,000 of sinking fund sixty year 5 per cent mortgage gold bonds, and by selling $50,000,000 of additional bonds of such issue for cash. As the preferred stock carries 7 per cent dividends, while the bonds would bear but 5 per cent interest, the $50,000,000 desired could, in this way, be added to the corporate resources, and the aggregate of the annual charges for interest and dividends, instead of being increased $3,500,000, would be decreased $1,500,000 as compared with the present sum total of these two requirements."

The plan offered to each preferred stockholder the right to subscribe to the new bonds to the extent of one-half his holdings of preferred stock, 40 per cent of each subscription to be

[1] From the *Quarterly Journal of Economics*, Vol. XVIII, 1903, pp. 22–53, with certain minor editorial emendations approved by the author. The genesis of the Steel Corporation and its promotion, finance, and capitalization are described in *Ibid.*, Vol. XV, pp. 517–550, and Vol. XVI, pp. 214–233. Both chapters are incorporated in his Trust Finance. — ED.

payable in preferred stock, and 10 per cent in cash, or the subscription could be limited to 40 per cent, in which event no cash payment was required. The circular also stated that a syndicate had been formed, "including some directors," to further the success of the plan; and, in the call for a special meeting of stockholders to be held May 19, one of the purposes of the meeting was stated to be the ratification of an agreement between the United States Steel Corporation and J. P. Morgan and Company, acting for this syndicate.

This agreement is dated April 1, 1902, and contains the following provisions:

1. That the party of the second part, known as "the bankers," on or before the first day of July, 1902, should offer to the preferred stockholders the right to subscribe to the second mortgage bonds of the company, on the terms mentioned in the circular, for a period of thirty days;

2. That such part of the $250,000,000 of bonds as should not be taken by the preferred stockholders, should be issued to the bankers on their request for the syndicate, to be paid for in preferred stock, and in cash, on the same terms as those offered to the preferred stockholders, in such amounts and at such times as the bankers might request, up to October 1, 1903;

3. That the bankers guarantee to the Steel Corporation that subscriptions to the new bonds to the amount of $100,000,000 would be made, payable $20,000,000 in cash, and $80,000,000 in preferred stock;

4. That, as compensation for the risk, the guarantee, and the various obligations assumed by the syndicate, the Steel Corporation should pay to the bankers a cash compensation equal to 4 per cent upon the aggregate amount of the bonds which should be sold or delivered, either to the preferred stockholders or to the syndicate, until October 1, 1903.

The plan and the syndicate agreement were submitted to the stockholders, and both were approved by a vote of 7,704,288 shares to 12,540 shares out of a total number of 10,185; 811 shares outstanding.

Before the plan could be put into effect, an injunction was applied for on June 8, 1902, before the Chancellor of New

Jersey, against J. P. Morgan & Co. by Miriam Berger, a preferred stockholder, to forbid them to issue bonds for stock under the bankers' contract, and alleging that the plan of conversion was unlawful for the following reasons: (1) that the plan, if carried out, would impair the complainant's vested rights as a stockholder; (2) that the plan of issuing bonds to retire stock was void against any dissenting stockholder; (3) that the plan was ruinous and disastrous, and impaired the value of complainant's stock; (4) that four members of the bankers' firm were directors of the corporation; and (5) that the compensation which might be received by the bankers under their contract was without consideration and illegal, and that the scheme was devised to secure exorbitant commissions by this firm. An order restraining the bankers from issuing any bonds in exchange for preferred stock was granted by Vice-Chancellor Emery on the ground that the complainant's vested rights would be impaired by the exchange of bonds for preferred stock under the terms proposed.[1] The case was appealed, the appeal being argued on June 25.

Before the appeal was decided, on July 5, a second bill was filed by J. Aspinwall Hodge, Bernard Smith, and William H. Curtis against the corporation, the bankers, and the directors.[2] The grounds on which relief was asked for were as follows:

1. That the plan interfered with the vested rights of the complainants;

2. That it was *ultra vires* and void;

3. That the Steel Corporation, under the act of 1902, could not issue bonds for stock, because it had not paid dividends on the preferred stock for at least a year preceding the date of the

[1] The ground on which the injunction was granted was: "that it (the conversion plan) is a preferential distribution of capital among some of the shareholders to the exclusion of others, and not a plan for an equal distribution among all the preferred stockholders. That the capital represented by preferred stock up to a limit of $200,000,000 is to be reduced to the extent the holders agree to take bonds, and . . . the stock of those who decline to take bonds is thus made subject to the prior claim and lien of those who take bonds."

[2] Smith and Curtis, it being proven that they were not registered owners of stock at the time suit was brought, obtained no recognition in the litigation. The right of Hodge to petition for an injunction was recognized.

meeting, and because its assets, after deducting the amount of its bonded debt, were not equal in value to the par value of its preferred stock;

4. That the scheme was disadvantageous, and would seriously damage the corporation and its stockholders, and that the compensation to the bankers was exorbitant;

5. That the action of the directors in approving the plan and contract was void, because fifteen or more of the board of directors were interested in the underwriting syndicate;

6. That the plan was never legally ratified by the necessary two-thirds vote of the stockholders, because the votes upon the stock controlled by the bankers and members of the syndicate must be counted to make up the two-thirds vote required by law.

The injunction asked for was granted October 29, 1902, on a portion of the third item of the bill of complaint, on the ground that only four continuous payments of dividends on the preferred stock had been made, the duration of the period from the time of the first declaration of a dividend, July 2, 1901, to the date of the stockholders' special meeting, May 19, 1902, being forty-four days less than one year, while five continuous quarterly payments should have been made to fulfil the requirements of the law. An appeal was allowed to the Court of Errors and Appeals, where the case was re-argued in the November term. Decision was rendered on February 18, 1903, reversing the Vice-Chancellor, and deciding in favor of the defendants, on the ground that all the requirements of the law had been complied with, and that "there is no ground presented by the case or agitated in the briefs of counsel which will justify the interposition of a court of equity to arrest the proposed action of the defendants." A similar decision had been rendered by the Court of Appeals in the Berger case on October 11, 1902. The Steel Corporation at once put its plan into effect.

It is proposed, in the following pages, to outline the principal arguments in the Hodge suit as found in the affidavits, briefs, and arguments of counsel. Space does not, however, permit an extended analysis of these arguments; and, for the most part, the merits of the controversy will be determined by the decisions of the Vice-Chancellor and the Court of Appeals upon the dif-

ferent points presented. The complainants in the Hodge suit presented the most varied and forcible criticisms which have been made of the bond conversion plan. It may also be presumed that the defendants placed their side of the question in the most favorable light. With the opinions of two courts to assist him, the reader will have little difficulty in determining on which side lay the weight of the evidence.

Omitting the claim that the vested interests of the complaining stockholders would be impaired by the proposed conversion of preferred stock into bonds,—this point being decided in the Berger suit in favor of the corporation,[1]—and passing over, as being of merely technical interest, the ground on which the Vice-Chancellor granted the injunction, we find that the complainants rested their case upon the following principal arguments:

1. That the action of the directors in sanctioning the plan was illegal, by reason of the private interest of several of their number, while the stockholders, to whom the extent of the directors' interest had not been fully disclosed, could not validate their illegal action;

2. That the scheme was vitiated by actual fraud, being plainly designed to favor J. P. Morgan & Co. and their associates, at the expense of the corporation;

3. That the contract with the syndicate was unfair to the stockholders, both in the length of time given to them to subscribe for the bonds as compared with the time allotted to the syndicate, and the unreasonable options granted to the bankers;

4. That the Steel Corporation did not have assets of the value required by law.

In developing the alleged illegal private interest of the directors, the complainants began by claiming that fifteen of the directors of the Steel Corporation, including the six members of

[1] Opinion of the Court of Errors and Appeals, Van Syckel, J., (p. 11): "That this plan involves a reduction of capital stock is conceded: it is the very purpose of the plan to reduce it and to retire it; but to the assertion that it is preferential, I am unable to assent. The same opportunity is given to all to accept the offer, none are excluded, and the complainant who has declined the offer cannot say to the ninety and nine who have accepted it that they have been preferred. There has been no preference on the part of the corporation; the position occupied by the complainant is of her own option."

the Finance committee, were members of the underwriting syndicate whose agreement with the syndicate managers was dated March 12, twenty-eight days before the resolution of the directors approving the contract between the syndicate and the Steel Corporation. In other words, at the meeting on April 1, when the contract with the syndicate came up before the directors, a majority of the board were "personally and individually interested in the profits and advantages to be derived by Morgan & Co. and their associates." . . .

These benefits were considerable. If the stockholders subscribed to the full amount of $250,000,000 of bonds, the syndicate would receive $10,000,000 in cash from the corporation. In addition to this large commission, the syndicate had the privilege of exchanging preferred stock for all bonds which were not taken by the stockholders; and this option, it was claimed, presented the certainty of a large additional profit. It is the law of New Jersey that where the personal interest of a director is concerned in a contract with his corporation, that contract is voidable. On this ground, the complaints asserted that the action of the directors was illegal.

The answer to this argument, reserving to a later page a discussion of the benefits of the contract, was short and decisive. Such contracts as the one in question, said the defendants, while voidable at the option of the stockholders, can be validated either expressly by a vote of the stockholders, or by the stockholders not electing to take any action in the matter. In the present instance, since the stockholders, by an enormous majority, had sustained the directors in their approval of the plan of conversion, to say nothing of the fact that the by-laws of the corporation expressly provided that directors might be interested in contracts with the corporation, and, further, "that . . . any act or contract that shall be approved or ratified by the vote of the holders of a majority of the capital stock of the company . . . shall be as valid and binding upon the corporation and upon all the stockholders as though it had been approved or ratified by every stockholder of the corporation," the court held that the infirmity in the contract had been entirely eliminated, and that the ratification of the agreement and plan was complete.

The complainants then attempted to show that less than the necessary amount of stock was legally voted, by setting up the plea that the members of the syndicate had no right to vote for the ratification of a scheme in which they were personally interested as opposed to the interest of the corporation, thus affirming the doctrine that the rights of a stockholder, when he becomes a director, are limited by the director's obligation to the corporation, which, it was alleged, was violated in the present instance, and going so far as to impose a similar obligation upon a stockholder who was not a director. This argument was stated as follows: . . . "It is contended that where a large number of stockholders conspire to impose a burden upon a corporation for their own benefit, ignoring the interest of the corporation, they thereby become constructively trustees for their fellow-stockholders, assume the obligations of trustees toward their fellow-stockholders, and must deal with them accordingly."

The defendants replied, and the court agreed with them, that a stockholder can never be deprived of his right of ownership in a corporation and of the right to vote the number of shares which he holds upon any question affecting his interest. Judge Van Syckel remarked in his opinion:

> They [the directors] voted upon that resolution, not as directors, not in their fiduciary capacity, but solely in the right of the shares of stock held by them. A most valuable privilege, which attaches to the ownership of stock in a corporation, is the right to vote upon it at any meeting of stockholders. As to the resolution considered by itself, as stockholders, they owed no greater duty to their co-stockholders than those stockholders owed to them. Like other stockholders, they had a right to be influenced by what they conceived to be for their own interest, and they cannot lawfully be denied that right, nor can it be limited or circumscribed by the fact that they occupied the position of directors in the company.

But, continued the complainants, granted that the vote was legal on the assumption that the stockholders fully understood the nature of the resolutions upon which they were voting, that assumption was contrary to the facts. The stockholders were not aware of the nature of the contract already made with the syndicate, nor with the extent of the personal interest of the

directors in this contract. The only information in regard to these matters contained in any of the documents sent to the stockholders, appears in the circular of April 17, and was as follows: "To further the success of the plan, there has been formed a syndicate, including some directors, which will receive four-fifths of the 4 per cent compensation to be paid under the contract with Messrs. J. P. Morgan & Co. mentioned in the notice of stockholders' meeting." It was further stated in the notice of the stockholders' special meeting, that copies of the directors' resolution, in which the nature of the contract was explained, and of the contract itself, could be obtained on application at Morgan & Co.'s office. This notice, the complainants asserted, was insufficient to acquaint the stockholders with the nature of these contracts which they were were asked to approve.

The defendants replied in the words of a decision upon another case cited in the brief of the defendants upon appeal:

> If the party notified make reasonable investigation, he obtains actual knowledge of these facts; if he choose not to make it, he is charged constructively with knowledge of them. . . . If he is unwilling to act upon the facts as the notice presents them, then the law demands that he shall make proper examination, and upon the result of that examination he may safely stand. . . . But, if he prefer not to examine, it must be because he is satisfied to act as if the matters disclosed in the notice were true, and he cannot afterward complain if his rights are made to rest upon them so far as they are true. The information given by the notice is equivalent to that obtained by the inquiry.[1]

This principle has been established in a number of cases. It was reaffirmed by the Court of Appeals in its decision that the information furnished to the stockholders of the Steel Corporation in regard to the various contracts and resolutions was sufficient to put them on inquiry. In fact, so little question was raised at the time concerning the expediency of the scheme that no stockholder applied to J. P. Morgan & Co. for a copy of the contract. The defendants were, therefore, apparently justified in their claim that the stockholders received all the information which they required.

[1] *Gale* v. *Morris*, 3 Stew. 285, 289, 290.

The Charge of Fraud

The evidence submitted by the complaining stockholders to substantiate their charge of fraud lay in the nature of the transactions in controversy. They claimed that the conversion scheme was bound up with the syndicate agreement; that it would not have been brought forward had it not been for the benefits which the syndicate was to derive; and that the compensation received by the syndicate, and the privileges allotted to it, were unreasonable and extortionate.

Here was a corporation, they said, in urgent need of at least $50,000,000 to complete improvements already begun, and to undertake further improvements whose completion would add at least $10,000,000 to its profits. This money was to be borrowed on the security of a second mortgage. The interest was to be provided by converting a 7 per cent dividend charge on $200,000,000 of preferred stock into a 5 per cent interest charge on the same amount of bonds. Ostensibly to insure the success of this plan, the aim and object of which was to raise a certain amount of cash, an underwriting scheme was devised, which, however, entirely subordinated the raising of cash to the conversion of stock into bonds. The underwriting plan devised by the directors undertook to guarantee, not the amount of cash required, but a plan of conversion whose complete success would not have increased the security of the proposed bond issue, nor have rendered the bonds more attractive in the eyes of investors, — a measure, moreover, which made inadequate provision for the real needs of the corporation. The syndicate, in other words, instead of guaranteeing to take $50,000,000 of bonds at par, and to pay for these bonds in cash, which the commonly understood principles of underwriting demanded, agreed to take only $20,000,000 of bonds at par, for which, after deducting their assured commission of $4,000,000 on the $100,000,000 of bonds whose purchase with cash and stock they had guaranteed, the corporation would receive only $16,000,000 of cash. Moreover, if the amount of bonds remaining should be taken by the stockholders, the additional commissions of the syndicate would reduce their actual cash guarantee

to $11,200,000, or little more than one-fifth of the amount which the stockholders have been told was necessary. On the basis of the actual cash furnished, the commission to the syndicate, assuming that the plan was successfully carried out, would be 44 per cent, — an extraordinary and unreasonable compensation.[1]

Furthermore, in answer to the argument set forth in the affidavit of Mr. Perkins, in which he claimed that, in the opinion of the Finance Committee of the Steel Corporation, the immediate effect of the announcement of the contemplated withdrawal of 40 per cent of the preferred stock would be to send its price above par, and so make conversion unattractive, and that the necessity of segregating a large amount of preferred stock in order to make sure that at least $80,000,000 of stock would be exchanged, as provided by the syndicate agreement, involved great risk and the locking up of a large sum of money for a considerable time, the complainants urged that, in any event, the bonds, which were, on the admission of the Finance Committee of the Steel Corporation, a higher grade security than the preferred stock, — else why convert the stock into bonds? — would always sell at a higher price than the stock, and that, therefore, the necessity of guaranteeing the conversion did not appear. There could be no reasonable doubt that the corporation could sell $20,000,000 of its second mortgage bonds for more than $16,000,000, the maximum amount of cash which it stood to receive from the syndicate. The assurance given by the syndicate that the amount required for distribution to the security holders would be decreased $1,500,000 per year could have no effect upon the price of the bonds, and could therefore lend only indirect assistance to the conversion. Moreover, a large amount of this $80,000,000 preferred stock was already the syndicate's property at the time the contract was made; and, so far from locking up funds in fulfilling their agreement, the members of the syndicate were in reality increasing the value of their property. In short, it was claimed that the guarantee of the syndicate contained an inconsiderable benefit for the Steel Corporation, in return for which the syndicate was to receive a large cash commission.

[1] Argument of Edward B. Whitney for Appellees, p. 21.

The Charge of Discrimination

In support of the charge of discrimination, the complainants argued that the plan created two classes of subscribers to the new bonds: (1) the syndicate; (2) the other preferred stockholders. Class 1 were offered the bonds at 96; class 2, at 100. Class 1 had an option on part of the bonds for seven and one-half months, and an option on such portion of the remainder as were not taken by the preferred stockholders for sixteen and one-half months, which period could be extended by agreement between the syndicate and the directors. Class 2 had an option limited to fifty-eight days. Class 1 could exchange their holdings of preferred stock to any amount, while class 2 were limited to 40 per cent of their preferred stock holdings. "The syndicate," said the complainants, "after cutting off the preferred stockholders not in the syndicate by the thirty (or fifty-eight) days' notice, could, at any time before the first day of January, 1904 (and later by means of extending the time), purchase 1000 shares of preferred stock at the market price, — say 83, — paying therefor $83,000; then call upon the Steel Corporation under one of the options to deliver to them bonds to the amount of $100,000 in exchange for the 1000 shares of stock, and sell the bonds at the market price, — say 95, — thus making $12,000 without the slightest trouble or expense, except that which would attend a few minutes' clerical work. And this process could be repeated in larger or smaller amounts from time to time, whenever the relative market prices of the stock and bonds should make it profitable to do so. Would not this be a palpable injustice to stockholders of the corporation, and especially to the preferred stockholders, not members of the syndicate, who had exchanged 40 per cent of their preferred stock for bonds?"

The answer of Mr. Perkins to this charge has been already referred to. He asserted that, without the guarantee of the syndicate, the success of the conversion plan would have been endangered by the appreciation in the value of the preferred stock. He does not answer the argument that the compensation was excessive in consideration of the benefit received by the corporation, except so far as to assert that the syndicate

agreement was "a most desirable one for the United States Steel Corporation," but rests the justification of the compensation almost entirely on the risk assumed by the syndicate.[1] In the Berger suit, where this point was more fully discussed, and to which constant reference was made in the Hodge litigation, the expediency of the contract with the syndicate was justified by the argument which Mr. Perkins employed, and the large risk incurred by the syndicate was thus explained in the brief of counsel for the corporation:

Is it reasonable to contend that the tying up of $100,000,000 of capital involves no risk or consideration and warrants no compensation? Can it be said that a syndicate, which undertakes an obligation of $100,000,000 and for the purpose of performing that obligation ties up by actual deposit $80,000,000 of property, is furnishing no consideration for an agreement to pay a commission? Suppose, pending action by the stockholders, the preferred stock of the syndicate had fallen in value from 94 to 87½ (as it actually did) or even lower, and there was a falling market occasioned by strikes or financial disaster, who would recompense the syndicate for the loss that it would sustain by the depreciation of its stock? . . . A variation of four points in the relative value of the seven per cent cumulative preferred stock and the new five per cent bonds would at once wipe out the profits of the syndicate and turn the venture into a loss. . . . For example, it may well be that the present market value of the proposed new five per cent bonds is 95, and that the present market value of the preferred stock is 88, a depreciation of 6 per cent since the syndicate deposited the $80,000,000 of stock. What, then, would be the outcome of the risk of the syndicate if the plan had been disapproved by the stockholders, or if it should now be set aside by the courts? The syndicate has tied up $80,000,000 of stock, which now shows a loss of 6 per cent, or $4,800,000, and this loss exceeds the promised commission, which they would not receive if the contract were not approved, and in addition the syndicate is

[1] The following quotation from Mr. Perkins's affidavit is of interest in this connection: "The largest participations in the syndicate were taken only after urgent solicitation by me and upon my agreeing that my firm would take an equal amount. The participation taken by Mr. Schwab and by some of the other directors was upon the understanding that, if we found other parties to take any part of such participations, we would do this, and thus release them. My firm considered, and I believe most of the directors believed, that the syndicate contract was not a particularly profitable one for the syndicate. In no instance did we find any stockholder willing to subscribe for the full amount of his holdings in preferred stock."

bound to take $20,000,000 of bonds, which bonds are only worth 95 in the market, showing an additional loss of $1,000,000. It is submitted that the mere statement of these facts must satisfy any court that the syndicate has since the first of April, 1902, run a very great risk, that it is still running a great risk, that in all fairness and propriety a reasonable compensation may be paid for that risk, and that the agreed compensation is not excessive.[1]

It is unfortunate that the defendants did not feel themselves compelled to legitimate the syndicate agreement, not merely by citing the risk undergone, but, as the complainants challenged them to do, by showing a corresponding benefit to the corporation. As complainants' counsel remarked:

The directors of an industrial corporation would not be justified in paying a million dollars to a person who offered to swim the Atlantic, unless they could show that some benefit would be conferred upon the corporation by the accomplishment of that feat. The fact that the gentleman proposing the scheme insisted upon the enormous risk that he ran would not justify the directors in closing the contract.

It would have been better, we must admit, if only for the sake of gaining a larger measure of general approval for their project, if the defendants had presented this portion of their argument in a less general and sweeping manner.

For the immediate purpose of winning their case, however, it was merely necessary for the defendants to keep before the court the fact that the contract between the Steel Corporation and Messrs. J. P. Morgan & Co. was approved of by more than 99$\frac{4}{5}$ per cent of the stockholders represented at the special meeting. Behind this fact, in passing upon the legitimacy of the transaction, in the absence of specific proof of fraud, the court could not go. As Vice-Chancellor Emery said in his opinion which was quoted in the decision of the appellate court:

The reasonableness or judiciousness, in the business aspect, of a reduction of the preferred stock of the Steel Corporation, and the distribution of capital resulting therefrom, by the conversion of stock into bonds, is . . . altogether a matter of management of the affairs

[1] Brief on Behalf of Defendants — appellants in *Miriam Berger* v. *United States Steel Corporation*, pp. 42, 43, 44.

of the corporation, upon which the decision of the directors and stockholders given in the manner required by law is final, so far as it relates to its business aspects.

And Judge Van Syckel, in the final decision, stated the same principle in more general terms, quoting from his opinion in the Berger case:

The manner in which a duly authorized plan is to be carried through is part of the business of the corporation, and, in the absence of fraud or bad faith, is not the subject of judicial control to any greater extent than any other business of the corporation. The court cannot substitute its judgment for that of the directors and majority stockholders, and say that a less expensive plan could be successfully adopted.

In short, so long as the directors acted in good faith and with entire frankness, they might, unless expressly forbidden by the law, have converted all their preferred stock into a 6 or 7 per cent bond; they might have incurred a floating debt equal to their mortgage indebtedness; they might have abolished the charge for depreciation; they might have paid their president a salary of $5,000,000 per year. In fact, they might have violated many rules of business prudence if only they could secure the approval of a majority of the stockholders. In New Jersey, a stockholder, generally speaking, is allowed to do what he will with his own.

That the court was convinced of the honesty and good faith of the transaction appears from the expression of Justice Van Syckel:

There is an entire absence in the case of anything to show a taint of fraud, or an attempt to conceal from the shareholders any fact which should have influenced their action. That the entire proceeding was conducted with good faith, without concealment, and with fairness to both parties, is evinced by the fact that during all the litigation which has ensued, under the promotion of a shareholder who did not attend the meeting, not one of the vast number of shareholders who were present in person or by proxy, comprising men of great business capacity, interested to the extent of millions of dollars in the conversion plan, has questioned its propriety, or expressed a desire, so far as appears, to recede from it.

The Valuation of the Assets

A New Jersey corporation cannot convert preferred stock into bonds unless its assets, after the deduction of all indebtedness, are equal to its preferred stock.[1] In their attempt to prevent the conversion of preferred stock into bonds, the complaining stockholders laid final emphasis upon the alleged fact that the assets of the Steel Corporation were not worth the necessary amount; namely, $880,024,900. In proof of this assertion, the complainants relied mainly upon the affidavits of one James H. Lancaster, who represented himself to be "a mechanical and mining engineer and expert on ores and steel and iron properties and their products." . . . Mr. Lancaster made two affidavits in the suit, — the first, a preliminary affidavit, on July 3, 1902, and the second, in more detail, on July 14.

In his first affidavit, Mr. Lancaster stated that he was "familiar with and had made a study of all the various properties and plants" of the Steel Corporation, that the plants and properties could be duplicated for about $300,000,000, and that the total value of all the properties, including good will and organization, was not worth $500,000,000.

Two weeks later, Mr. Lancaster, in his second affidavit, went into the subject of valuation in more detail, and presented the statement upon which this portion of the complainants' case was to depend. He stated, first, that the plants of the Carnegie company, representing 44 per cent of the productive capacity of the Steel Corporation, had been valued on March 12, 1900, by the partners of the Carnegie Steel Company at $75,600,000. This valuation was stated in the answer of the company to Mr. Frick's bill of complaint to be "a full, fair, and accurate valuation of these assets," and also that "the experience and judgment of business men justify us in saying (as we do) that such a method of valuation in large manufacturing companies, and especially of iron and steel in our country, as a rule, is more liberal to the seller than to the buyer; for experience has shown that partnership assets on a just appraisement seldom reach

[1] This was the act of March 28, 1902, under which provisions the plan of exchanging bonds for preferred stock was authorized.

the value at which they stand on the books of the concern." Mr. Lancaster, accepting this statement as accurate, estimated the total value of the Steel Corporation's properties, upon the basis of the 1900 valuation of the Carnegie properties, and including $27,000,000 of Frick Coke Company assets subsequently added, at $200,000,000.

He also presented a table showing the conversion value of the securities of the constituent companies in the securities of the United States Steel Corporation, as follows:

	Common Stock	Preferred Stock	Bonds
Constituent companies	$300,000,000	$247,000,000	$219,000,000
United States Steel Corporation	508,000,000	510,000,000	362,000,000
Increase	$208,000,000	$263,000,000	$143,000,000
Percentage of increase	69	106	65

The inference drawn from this comparison of capitalizations was that, unless the capital of the constituent companies was far below the value of their assets, the capitalization of the United States Steel Corporation greatly exceeded the value which supported its securities. Mr. Lancaster concluded his affidavit by expressing the opinion that the 1902 earnings of the United States Steel Corporation represented the results of an exceptionally prosperous condition of the market, and that many new plants were then building to compete with the corporation in all its departments.

The arguments of complainants' counsel in support of these affidavits were mainly taken up with showing that the iron and steel trade was subject to sudden and extreme reverses and to long periods of depression, and that these contingencies had not been allowed for in the capitalization of the Steel Corporation. They contended: (1) that the value of a group of assets was based on the selling price of those assets, which in turn depended solely upon their earning power, and that, while the Steel Corporation was then earning interest and dividends on all classes of its securities, there was no assurance that these

earnings would be sufficiently permanent to warrant the belief that the selling value of the company's assets could properly be based upon a capitalization of their amount; (2) that the 1902 price of steel was an abnormal price, dependent on temporary conditions, and resulting in earnings which should be disregarded in making an estimate of the ability of the corporation to pay the large increase in interest charges which would result from the success of the conversion plan; (3) they asserted that the directors of the Steel Corporation were about to carry through a plan which was not merely unnecessary and expensive, but dangerous as well, — a plan which would increase its mortgage debt beyond what experience showed would be the minimum value of its assets, a plan whose success spelled bankruptcy, should the history of the steel trade be repeated. The argument of the complainants, in brief, was based entirely on considerations of business probability, and on the results of business experience. Affirming that the requirements of the New Jersey corporation law were designed for the protection of the investor, they asked the court to interpret the meaning of the statute in the light of business probability, and to refuse its sanction to a measure which conservative judgment would disapprove.[1]

This, however, as shown by its refusal to throw out the conversion plan because of its alleged expensiveness, the court was not prepared to do. So long as the requirements of the law were complied with, which in this case meant a certification by the officers of the corporation that its assets, after deducting all indebtedness, were equal in value to the amount of its preferred stock, and in the absence of fraud, the court had no right to interfere.

This certification was furnished in a series of affidavits remarkable because of their prodigal frankness and the varied standards of valuation which they set up. The subject-matter of these affidavits, so far as they relate to the question of assets, may be

[1] Argument of Edward B. Whitney (p. 41): "I submit that the sole object of the Legislature in establishing this restriction as to the amount of assets was to make the recapitalization entirely safe for at least the preferred stock, . . . to secure that in case of insolvency a foreclosure of the new bonds would result in the realization of the full value of the preferred stock if the latter were properly protected."

divided as follows: (1) valuations of property; and (2) estimates of future earnings. The leading affidavit for the defendants was made by Mr. Schwab, who swore to the statement that the total value of the corporation's assets, without making any allowance for good will and established business, patents, trade-marks, and processes, or for $150,000,000 of orders on hand, exceeded the total amount of its capitalization. This statement was not made in general terms, but was supported by a list of assets, giving the value assigned to each and the basis of valuation employed. For purposes of convenience, the material of this affidavit has been arranged in the following table:

Assets	Valuation	Principles governing Valuation
1. Iron and ore properties.	$700,000,000	1. Properties cannot be duplicated at any price. 2. Yield direct profit of $30,000,000 on present price of ore. 3. The Steel Corporation would be compelled to pay $700,000,000 in order to obtain these deposits.
2. Plants, mills, fixtures, machinery, equipment, tools, and real estate.	$300,000,000	1. Impossibility of duplicating these mills for a less amount. 2. The mills are necessary to make the profits of the corporation, stated to be at the rate of $140,000,000 per year.
3. Coal and coke fields (87,589 acres).	$100,000,000	1. Net profits to the corporation, based on the present prices of coal and coke, over $12,000,000.
4. Transportation properties.	$80,000,000 after deducting $40,340,000 of bonded debt.	1. Cost of duplication. 2. Profits of mills increased $10,000,000, because of possession of transportation facilities.
5. Blast furnaces.	$48,000,000	1. Cost of duplication.
6. Natural gas fields.	$20,000,000	1. Profit of $2,000,000.
7. Limestone properties.	$4,000,000	1. Cost of duplication. 2. Profit of $500,000.
8. Cash and cash assets.	$214,278,000	1. Cash assets valued at cost.

Mr. Schwab employs two leading principles in valuing these assets, — (1) cost of duplication and (2) profits derived from their possession. Of his estimate of $140,000,000 as the earnings of the corporation, $54,500,000 is directly accounted for by the savings on ore, coal and coke, transportation, limestone, and natural gas. The direct profits of the mills easily make up the remainder.

Mr. Schwab's affidavit was supplemented by the affidavits of other officials. Mr. Elbert H. Gary, chairman of the Finance Committee, testified that the "intrinsic value" of the properties, as set forth by Mr. Schwab, were true and conservative. Mr. James Gayley, first vice-president, and in general charge of the mining and transportation of raw material, stated in his affidavit that the ore properties of the corporation were not only the most extensive known, but were of such high grade and quality as to make them specially suited to the production of the best quality of iron and steel; and: "that investigations have demonstrated that the deposits of this region are practically circumscribed as to quality, and that, if any new deposits are to be found, it will undoubtedly be at points which are much further removed from sites suited to the economical manufacture and distribution of product," and, further, "that they could not be duplicated or reproduced at any price."

President Lynch, of the Frick Coke Company, supported Mr. Schwab's statement by the assertion that the 315,000,000 tons of coking coal still contained in the Connellsville basin were worth, on a profit of 50 cents per ton, — 75 cents below the profit then being made, — $157,500,000. President James H. Reed of the Pittsburg, Bessemer & Lake Erie Railroad Company, in perhaps the most carefully worded affidavit of the series, affirmed that the cost of the transportation properties of the corporation, after deducting the amount of their bonded debt, was approximately $50,000,000, and that their cost of duplication would be far in excess of this amount, since in many cases it would be impossible to duplicate these facilities. The final affidavit as to the value of the property was made by William J. Filbert, comptroller of the Steel Corporation, who stated that on the basis of the highest prices reached for the two stocks,

the total market value of all the corporation's securities was $1,149,014,932.

The defendants were also at considerable pains to controvert the statements, sworn to in the Carnegie-Frick litigation of 1900, that $75,600,000 represented a "full, fair, and accurate valuation of the Carnegie Steel Company's assets." James J. Campbell, auditor and assistant secretary of the Carnegie company, in his affidavit demolished the truth of the statement made by the defendants in *Frick* v. *The Carnegie Steel Company*. He showed that all the properties of the Carnegie Steel Company had been carried on the books for many years at the original costs, and that no allowance had ever been made for the money expended on them for improvements, which in some instances far exceed the original outlay. The question at issue in the Frick-Carnegie litigation, said Mr. Campbell, did not concern the actual value of the Carnegie company's property, but merely involved the basis of settling for the interests of deceased or withdrawing partners. Mr. Schwab also took the same ground in his affidavit: "It was claimed in such litigation, and such was the fact, that the book value did not represent the actual value of the properties. Under the terms of the agreement to which Mr. Frick was a party, it was provided that the book value should determine the interests of the several associates, and the controversy between Mr. Frick, on the one hand, and Mr. Carnegie and his associates, on the other, was as to whether this nominal book value should control, or the actual value, which Mr. Frick alleged to be in excess of $250,000,000."

The defendants did not stop with estimates of present valuation. They accepted the standard of business probability which the complainants claimed should be applied to determine the value of the Steel Corporation's assets, and asserted that, in their judgment, the earnings of the Steel Corporation would never fall so low as to endanger the interest on the second mortgage bonds. As a matter of record, these predictions should be preserved.

Mr. Schwab stated that, if the conversion plan were carried through, the fixed charges of the corporation — he makes no allowance for depreciation — would be $31,737,850. The earn-

ings of the corporation were then more than four and one-half times this amount, leaving a margin of 75 per cent above the danger of bankruptcy. "The most careful investigation," said Mr. Schwab, "was made at the time the board of directors voted to recommend the issue of $250,000,000 of second mortgage bonds, to determine whether, under any reasonable possible conditions, the earnings of the Steel Corporation would be reduced below the total fixed charges of $31,737,850. The unanimous opinion of the officers and directors who had a lifetime of experience in the business was that, under no conditions of the iron and steel trade or of business depression, was there any reasonable likelihood that the earning capacity of these vast properties would be reduced to any such extent." This part of Mr. Schwab's affidavit was repeated in almost identical terms by Mr. Gary, who stated that the board of directors was unanimously of this opinion. It is unfortunate that these vigorous statements do not start from an assumption of at least $60,000,000 of fixed charges, for, on Mr. Schwab's basis of valuation, a $30,000,000 charge for depreciation would be none too large.

Under the weight of this mountain of testimony, the arguments of the complainants, which they admitted were founded on "*ex-parte* and argumentative affidavits," were crushed to the ground. They were forced to admit that their part of the case was in a condition far from satisfactory, and, in fact, were unable to bring any rebuttal evidence or argument worthy of comment, contenting themselves with repeating their original contentions.[1]

Furthermore, the appearance of Mr. Lancaster in the case gave the defendants an opportunity to impeach the good faith of the suit, which they did not fail to improve. As an illustration of the motives which animate the movers in these so-called "strike suits," of which it was charged that this was an example,[2] a portion of

[1] Extract from Section VIII of Brief for Complainants on Appeal: "The complainants' papers at the commencement of this litigation were necessarily prepared hastily, and it is obvious that great labor and a long time would be required, especially for parties not having access to the books and papers of the corporation, to make an inventory of the property, even approximately accurate . . . We frankly concede that the record on the question of value is not in a satisfactory condition from the complainants' point of view."

[2] See page 176 *infra*.

the affidavit of Joseph E. Corrigan, an attorney in the office of Guthrie, Cravath & Henderson, may be advantageously presented. Mr. Corrigan stated that on August 15 Mr. Lancaster, on his own initiative, made to him and Mr. Guthrie substantially the following statement:

"That on the third day of July, 1902, a young man named Preskauer handed them the business card of the law firm of James, Schell & Elkus, and told him that Mr. Elkus wanted to see him at his (Elkus') office. That he at once proceeded to said office, and there for the first time met Mr. Elkus whom he had never known before. That he was introduced by Mr. Elkus to David Lamar, that said Lamar thereupon talked to him in the presence of said Elkus about the United States Steel Corporation's properties and their values, and after some conversation said that he desired an affidavit as to the values; that said Lancaster did not know and was not told that the affidavit was to be used in litigation, and did not observe any title of a suit, to what at the time he swore to. That he protested that it was impossible for him in so short a time to make an affidavit; but that said Lamar said they would be satisfied with his present impressions, and what he knew generally about the steel business; and that they would give him $100 for the affidavit. Said Lancaster further stated that he needed the money, and that, as this was an easy way to make $100, he was willing to swear to the affidavit, although he did not know what it was to be used for, and supposed it was simply for said Lamar's information, or for some purpose said Lamar had in mind, and that he gathered from what Lamar said to him that it was to be a guide for investing in stocks. Said Lancaster further stated to Mr. Guthrie and myself that, a few days afterwards, he for the first time ascertained that his affidavit had been used in a suit against the United States Steel Corporation. That he went at once and protested to Mr. Lamar . . . that he had been deceived. Said Lamar thereupon agreed to pay him $250 a week and $10,000 when they succeeded in making a settlement, which he (Lamar) assured Lancaster would not be later than November 1. That he made a second affidavit in the suit, for which he was paid $400. That he then had a row with Lamar over the subject of

his compensation, that he threatened to expose them all, and that finally Lamar agreed to pay him $500, making $1000 in all, provided said Lancaster would execute a general release and sign a letter to the effect that he would not disclose to any one what had occurred in Mr. Elkus' office — that he understood from what Mr. Lamar and others said in Mr. Elkus' office that they expected to make big money out of the suit, and that a number of the suits were in preparation and would be brought one after another until a settlement was forced."[1]

The weight of the argument as to the value of the Steel Corporation's assets was plainly with the defendants. Vice-Chancellor Emery supported their contention at every point. He stated in his opinion that the certificate of value required by the law had been filed by the proper officers, and that "upon the affidavits filed there can be no question whatever as to their honesty and good faith in making this certificate as to value." This certificate, it is true, was not conclusive evidence, but might be shown to be false. The proof of its falsity, however, in this case, had not been furnished. The affidavits filed by the defendant company, said the Vice-Chancellor, on this question of the value of the assets, are "full, complete, and detailed, and are made by persons entirely familiar with the property, or portions of the property, as to whose value they affirm. The affidavits as to value filed by complainant are, on the other hand, general, vague, and made without special knowledge or examination, and the credibility of the principal affiant on the part of the complainant is seriously impaired by his own admissions in his latest affidavit. Upon these affidavits as to value, I would not be justified in enjoining the issue of the bonds, pending the final hearing." The Court of Appeals, while passing upon the arguments of the complainant, apparently did not consider the discussion of the value of assets of sufficient importance to even refer to it.

The United States Steel Corporation, in the Hodge suit, won a complete victory. Its opponents were not merely routed, but

[1] Lancaster, in a supplementary affidavit, denied the correctness of some of Mr. Corrigan's statements, but admits their general correctness, and places himself in a generally unfavorable light.

the honesty of their motives was seriously impugned. The legality, and, so far as the court went in this direction, the wisdom of the plan for converting bonds into stock, were upheld. The vindication of the defendants could not have been more complete.

There is, however, another side to the question. Apart from the provisions of the New Jersey corporation act which the directors were careful to obey, the facts brought out by the Berger and Hodge suits constitute a serious indictment of the wisdom of the bond conversion plan. Surely, at this late day, few will be found to indorse a plan to change a dividend requirement on $200,000,000 of stock into an interest requirement on $200,000,000 of bonds, for no better reason than to save the interest and sinking fund charges on an additional $50,000,000 of bonds. The mere statement of the plan, which runs directly against every recognized canon of corporation finance, is sufficient to secure its condemnation. The proposal ignored the mortgage lien of the bonds which were to be substituted for stock, and the fact that with the issue of the new bonds the borrowing capacity of the corporation would be exhausted, for the sake of saving $4,000,000 in dividend payments, 2 per cent of the net profits of the company in 1902.

We have become familiar with plans for the conversion of bonds into stock where the purpose is to reduce fixed charges. Projects for purchasing stock with bonds secured by the stock — for example, the purchase of Burlington, Jersey Central, and Louisville & Nashville — are not uncommon. In such cases, the purchasing company can apply the dividends on the stock to the payment of interest on the new bonds; and the lien, aside from a guarantee which can be enforced only with great difficulty, is on the stock which the bonds were issued to purchase. Such projects have to commend them either the reduction of fixed charges, or the gaining control of companies where control means a large increase in the earnings of the parent corporation. But to propose a conversion scheme for no better reason than to reduce dividends in favor of interest, is a proposition which has little to commend it.

Then, too, can the syndicate agreement, when drawn from under the healing wings of the stockholders' approval, stand the test of critical examination? The theory advanced by defendants' counsel, that the amount of the syndicate's compensation should be determined, not by the benefit to the corporation, but by the risk of the syndicate, would seem to be untenable. Underwriting syndicates are usually supposed to guarantee cash. Their commission is based upon the amount of cash for which they are liable. The maximum commission in the case under consideration was 44 per cent of the cash guarantee, — an amount out of proportion to the benefit received. The argument that it was necessary to sequester a large amount of preferred stock in advance of the announcement of the conversion plan, because of the practical certainty that the announcement would raise the price of the preferred stock above par and make conversion undesirable, is singularly weak. In what manner the placing of $12,500,000 of interest charges ahead of the preferred stock dividends, would advance the value of the latter security, can better be imagined than described. The course of the preferred stock since the conversion plan was announced offers an interesting commentary upon the prescience of the Finance Committee.

Space does not permit an extended examination of the methods employed in valuing the assets of the Steel Corporation. At the time these affidavits were made, there can be no question that, as worded, they deserved the high praise awarded them by the Vice-Chancellor, of being full, complete, and detailed, and of being made in honesty and good faith. In July, 1902, the corporation was earning at the rate of $140,000,000 per year; and the "present worth" of its assets, which is the plain meaning of the law, was in excess of $1,400,000,000. If the argument of the complainants was to stand, the law should have read something as follows: "that no corporation shall be permitted to retire its preferred stock by the issue of bonds whose earnings, in the judgment of some competent tribunal, shall not at all times be adequate to pay dividends on the preferred stock." In such an event, however, the question would never have come before the court in the course of litigation.

It would have been definitely settled beforehand. As the law stands, and looking only to present value, the adequacy of Steel Corporation's assets in July, 1902, to conform to the requirements is evident.

But what shall be said of the wisdom of the policy which accepts such a valuation as a basis for incurring $10,000,000 additional of fixed charges without corresponding increase of assets? The fixed charges of the Steel Corporation, assuming that the conversion scheme had been a complete success, and making adequate allowance for depreciation, would have been at least $70,000,000 per year. As they now stand, with only $150,000,000 of preferred stock exchanged, they are not far from $65,000,000.[1] Here is a necessary reduction in earnings before the limit of fixed charges is reached, not of 75 per cent, as stated in the directors' affidavits, but of 50 per cent. There will be few persons found, who are in any way conversant with the history of the steel trade, to affirm that the earnings of any steel corporation could not be reduced one-half by a very moderate decline in prices The Steel Corporation averaged a profit of $16 per ton during 1902. It may fairly be questioned whether the conditions of competition and demand warrant the proposition that a profit of $8 per ton can be secured when the trade is at its lowest ebb.

As above remarked, however, while the directors were ready to swear to the belief that the profits of the Steel Corporation would never be reduced as low as $31,000,000, they included no allowance for depreciation in their estimate of fixed charges. Their judgment would not, therefore, be impeached, should the earnings of the Steel Corporation fall below its fixed charges. If the rule be accepted, however, — that, in issuing bonds, a corporation should always maintain a wide margin between minimum net earnings and fixed charges, — it is impossible to approve a plan to add $12,500,000 to the interest charges of

[1] This statement is not based upon official announcements, but upon common report at the time the life of the syndicate was extended. If the gap between preferred stock and bonds is not closed, there is every reason to expect that the operations of the syndicate in purchasing preferred stock for retirement will insure the final success of the plan of commission.

the United States Steel Corporation. The fixed charges of the company were too high before for entire safety. The issue of $250,000,000 of bonds, or even $150,000,000, can be described by no other word than unwise.

The Hodge and Berger suits may have been inspired by improper motives, but they have served to call attention to certain glaring defects in American corporation law. The time has gone by when the determination of great questions of corporate policy, involving the welfare of the community as well as the interests of stockholders, can be safely left to their own judgment. The average stockholder in corporations such as the Steel Corporation is incapable of forming a judgment on questions such as those under discussion. He is one of a flock of sheep who follow first one false shepherd and then another, until, inverting the parable, for every sheep that is safely folded, ninety-and-nine are hopelessly led astray. He invests because he has confidence in some individual. Unfortunately, his confidence is frequently misplaced. The laws of those states, such as New Jersey, in which most large companies are incorporated, give the stockholders abundant protection against directors and officers who attempt, by concealment and fraud, to violate their trust. These laws, however, give no protection to the stockholder against his own ignorance and credulity. If the stockholder was the only one to suffer the consequences of his own simplicity, there might be no reason for advocating a plan of federal control which would compel directors to follow a conservative policy in the distribution of earnings and the readjustment of capital. But where the history of each day is furnishing new evidence that the prosperity of the community is jeopardized by reckless financiering, it is plain that the people should, for their own protection, take out of the hands of stockholders the control of matters with which they are incompetent to deal, and by the enactment of laws similar to those which regulate the conduct of national banks, compel directors to keep at all times within the limits of conservatism.

If the tremendous decline in the securities of the largest industrial corporation in the world — a decline which is almost without parallel, and which has inflicted heavy losses upon tens

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If the tremendous decline in the securities of the largest industrial corporation in the world — a decline which is almost without parallel, and which has inflicted heavy losses upon tens

of thousands of stockholders — shall furnish the object-lesson necessary to bring the American people to their senses upon this question of the necessity of rigid federal control of large corporations, the United States Steel Corporation will not have lived in vain.

EDWARD SHERWOOD MEADE.

THE UNIVERSITY OF PENNSYLVANIA.

THE STEEL CORPORATION'S BOND CONVERSION: A CORRECTION[1]

In the preceding article Professor Meade gives prominence to the recent suit of Mr. Hodge against the Steel Corporation, referring to it as if it might have been a "strike suit." That the defendants in this suit could obtain a withdrawal without pecuniary outlay was well known to them. Mr. Hodge's offer of withdrawal, made through me in writing at an early stage of the litigation, asked simply a resubmission of the scheme to the stockholders with full information as to its main features, or else its modification by taking from the Morgan syndicate all advantage over the other preferred stockholders, giving it no longer option to subscribe for the bonds, no greater time to pay subscriptions, and no commission except upon the amount which the syndicate should absolutely bind itself to underwrite.

The point upon which the Vice-Chancellor decided the case in Mr. Hodge's favor, if sustained, would have forced a resubmission to the stockholders. It would probably then have been voted down. The notice upon which their proxies had been obtained had been so drawn as to give the impression that the whole bond issue had been underwritten; and the syndicate's extraordinary option was not apparent. The stockholders were indeed informed that by calling at the Morgan office they could secure complete copies of the proposed contract; but, as Professor Meade truly says, nobody called. Each assumed that he had enough information, and did not need to examine legal documents. The most interesting question to the public in the

[1] From the *Quarterly Journal of Economics*, Vol. XVIII, 1904, p. 303.

Hodge suit was whether this notice sufficiently discharged the duties of the directors. The New Jersey court held that it did. Other courts have set up a much higher standard, and required of interested directors the fullest disclosure. The standard set by the state which has fathered so large a proportion of the modern "trusts" has had no small influence upon public confidence in their securities.

Time has already vindicated Mr. Hodge. Public sentiment recognizes this, and has forced the surrender of the syndicate option. Mr. Schwab's valuations have been condemned by the market, and by the abandonment of dividends, to the loss of so many common stockholders. The principle of his valuation, that in bonding a company it should be capitalized on the basis of the profits of a year of prosperity, instead of upon the availability of its assets in a period of depression, was never indorsed by conservative men, although it passed muster with the New Jersey courts.

The fact that Mr. Hodge was publicly joined as complainant by no other stockholder of record was not due to lack of sympathy, — of that he received a plenty, — but to two conditions which are among those that most contribute to the success of the modern "trust" financier. Persons with large interests at stake cannot afford to join openly, because they are afraid that the dominant powers in Wall street may take revenge by attacking their financial credit and excluding them from profitable enterprises. Small stockholders have not sufficient interest pecuniarily to justify the annoyance and notoriety and the newspaper abuse to which they would be subjected. Even necessary expert testimony is difficult and expensive to obtain, through fear of boycott; and the swiftness with which the directors' plans are carried through after their announcement leaves stockholders but little time for consultation and none for deliberate action. It is only when the plans fail for other causes, as in the shipbuilding case, that the minority have time for investigation or combined action.

EDWARD B. WHITNEY.

NEW YORK.

THE LATER HISTORY OF THE UNITED STATES STEEL BOND CONVERSION[1]

THE underlying motives for this most extraordinary fiscal operation have been variously interpreted. It has been freely ascribed to the desire of important owners of the preferred stock to dispose of their unwieldy holdings to the public in the form of bonds. Others allege that participation in industrial investments by large life insurance companies would be less indefensible in the purchase of bonds than of preferred stock. Even among the large body of private investors, there are many who will purchase bonds, but will buy stocks only of the highest grade. The bond having a right of foreclosure cannot decline in value below a point determined by its equity interest in the property. Stocks are not thus limited as to their possible decline in value; but may fall to any degree. A double motive, in the judgment of authorities, existed. The bonds would naturally have a better market than the stock. The stock, also, if on a dividend basis would command a better price, if the supply of it in the market were thus reduced. This consideration, in days of "undigested securities," was an important one. That imperative need of cash for improvements was not the sole motive, as publicly alleged by the company, would seem to follow from a number of considerations. For, in the first place, cessation of dividends on common stock would speedily have supplied the necessary funds from current earnings, following the conservative policy of railway companies, without resort to conversion at all. This expedient was certainly possible under the conditions which prevailed when the plan was resumed in March, 1903. A year of litigation had resulted in a dissolution of the injunction granted by a lower court. Enormous earnings of the company meanwhile had resulted, in December, 1902, in "undivided earnings" of $33,841,565 upon the year's business. Under such circumstances the imperative need for cash urged on behalf of the original plan certainly did not exist. A second cogent criticism against this alleged motive is that the plan as

[1] From the *Quarterly Journal of Economics*, February, 1905.

approved, and afterwards as actually carried out, would result in entirely insignificant cash receipts as compared with the magnitude of the other operations involved. At the most, the only source of ready cash from the plan would be the sale of $20,000,000 of bonds at par, from which the commission of 4 per cent for the syndicate would be necessarily deducted. Yet the official statement given out on November 19, 1903, by the Executive Committee of the Board of Directors showed that only $2,902,000 of such bonds had been actually sold at par for cash, paid for in full October 1, and already issued. On the remainder of the minimum $20,000,000 of bonds guaranteed by the syndicate for cash on October 21, only 25 per cent had been called for and paid to the corporation. Had the real reason for this entire operation lain, as alleged, in the imperative need for cash, why was not the syndicate called upon promptly for the balance of its guarantee?

From the foregoing considerations it seems perfectly clear that an important motive for this transaction was to secure a large profit to prominent bankers who were represented at the same time on the Board of Directors of the Steel Corporation. This interpretation seems to flow from the original plan as proposed. It derives added force from the subsequent history of the enterprise. Stockholders were permitted until May 16, 1903, to take advantage of the conversion scheme. At that time the bonds were selling above 90 and the preferred stock was a few points lower. The exchange would therefore leave a profit probably less than 5 per cent. The syndicate, however, had not only *guaranteed* a conversion of $80,000,000 of this preferred stock; but its contract provided that it might, if so disposed, convert the balance of the $200,000,000 of preferred stock authorized for exchange into bonds. The life of the syndicate was to terminate October 1, 1903. Meanwhile the margin between the market price of the new bonds and the preferred stock had perceptibly widened. In other words, depression in the steel industry was becoming evident. Suddenly the financial community was startled by a circular notice announcing that the life of the syndicate had been extended from October 1, 1903, until

the following July.[1] Obviously this cleared the way for a continued conversion of the preferred stock into bonds at a continually growing profit determined by the widening margin between the two classes of securities. This profit was not open to the general stockholders whose option had expired in the preceding May. November brought news of still further trade contraction, until the preferred stock was quoted at about 50, while the new 5 per cent bonds were selling some fifteen points higher. This meant a profit of about $150 per bond, exclusively reserved to the banking syndicate. Moreover, a cumulative process was evidently involved, inasmuch as the greater the amount of conversion, placing bonds ahead of stock, the less was the preferred stock on the market worth. This scandalous condition of affairs finally induced the company to terminate the contract and limit the amount of conversion to $150,000,000 in place of $200,000,000 as originally planned.[2]

The net results of the transaction would seem to be as follows. Of the $50,000,000 bonds originally to be sold for cash, none were taken by the public. The price never rose above 95, while they were offered at par. The syndicate assumed its guarantee of $20,000,000 at par, but only a small fraction of this offer of cash had been taken by the company when the contract was cancelled. As to the $200,000,000 of preferred stock to be converted (afterwards reduced to $150,000,000), outside shareholders whose rights expired in May availed themselves of the privilege to an amount variously estimated at from $35,000,000 to $50,000,000. The syndicate, compelled by its guarantee to convert $80,000,000, must therefore have taken care of the balance of $150,000,000. This last was the limit finally set by the company on terminating the contract upon completion in November, 1903. The results to the United States Steel Corporation of the entire transaction were then twofold. At best, an insignificant amount of cash was provided, not all of this being taken as offered. Secondly, an evident saving in the annual charges was made, determined by the difference between the dividends on old preferred stock at

[1] Official documents are reprinted in Moody, Truth about the Trusts, p. 185.

[2] A searching analysis of this phase of the matter is given by A. D. Noyes in *The Forum*, January, 1904, pp. 368 *et seq.*

7 per cent and the interest at 5 per cent on the new bonds. But as an offset to this, as previously shown, was the fact that the new bonds were a fixed charge with foreclosure rights, while the dividend payments were contingent upon earnings. There remains, then, for discussion only the amount of profit which must have accrued to the syndicate, many of whom were directors in the company; a profit which, had no options been given to the syndicate, could have been made by the Corporation itself. As a loss must be reckoned the sale of the bonds at figures ranging from 95 down to 75, such bonds having been taken at par. On the other hand, profits arose from two sources. The cash commission at 4 per cent on $170,000,000 of the new bonds was considerable and certain. In addition to this came the exclusive privilege after May, 1903, of converting the stock into bonds at a margin of difference vastly greater than could have been contemplated when the contract was drawn. Whatever, legally, the judgment of the courts may have been, as hereinbefore described, there can be no doubt that from a fiscal point of view the entire operation betrayed a disregard of the principles of sound finance and even of common honesty and fair dealing with the stockholders.

William Z. Ripley.

IX

UNITED STATES SHIPBUILDING COMPANY[1]

Incorporation

THE United States Shipbuilding Company was incorporated on June 17, 1902, under the laws of the state of New Jersey. The incorporators were Howard K. Wood, Horace S. Gould, and Kenneth K. McLaren. . . . The incorporators collectively subscribed for fifteen shares of the preferred and fifteen shares of the common stock of the company.

On June 24, 1902, the incorporators above named, constituting the stockholders of the company, held their first meeting. . . . At this meeting Frederic K. Seward was elected a director for one year, Raymond Newman was elected a director for two years, and Louis B. Dailey was elected a director for three years, the minutes of the company reciting that Howard K. Wood, one of the incorporators and subscribers to the stock, had assigned his right to one share of common stock to each of the persons above named to qualify them as directors. No stock of the United States Shipbuilding Company, however, was issued to or placed in the name of these directors, so far as the records of the company disclose.

On the said 24th day of June, 1902, the first meeting of the directors of the United States Shipbuilding Company was held. At this meeting there were present Louis B. Dailey, Raymond Newman, and Frederic K. Seward, being all of the directors. The minutes recite that the Board proceeded to the election of officers for the ensuing year, and, ballots having been cast and counted, it was found that Raymond Newman had been elected

[1] From Report of James Smith, Jr., Receiver, filed Oct. 31, 1903; United States Circuit Court, District of New Jersey, *R. R. Conklin, et al* v. *United States Shipbuilding Co.* [Condensed by omission of immaterial parts and legal repetitions.]

president; Louis B. Dailey, vice-president; and Frederic K. Seward, secretary and treasurer. The persons above named as incorporators were . . . all connected with the Corporation Trust Company of New Jersey as officers or otherwise, and the place of residence above stated being the New Jersey office of said Trust Company. The directors were also employees of said company.

At this meeting of the directors an offer was received from one John W. Young, of which the following is a copy:

Offer of Promoters

New York, June 24, 1902.

To the Board of Directors, etc.,

I hereby offer to convey, sell, etc., . . . unto your Company for the consideration hereinafter stated, the following property, viz.:

(1) All of the capital stock of the Union Iron Works of San Francisco, Cal., . . . together with all of its property, real and personal, business and good will as a going concern, I hereby agreeing that this corporation has no bonds out and no indebtedness except current accounts, etc.

Messrs. Henry T. Scott and Irving M. Scott have agreed with me . . . to enter into the usual contract with your Company not to compete with it in its business, and not to employ their capital . . . for the period of ten years.

This offer of the stock and property of the Union Iron Works is made also upon the following express conditions, viz.: That your Company shall enter into a contract extending over a period of five years with Messrs. . . . , now connected with the management of the Union Iron Works, to act as officers or managers . . . for this period of five years at an annual salary to be paid to each of $10,000, etc.

(2) The entire capital stock of the Harlan & Hollingsworth Company of Wilmington, Del., etc.

(3) Also the entire capital stock of the Eastern Shipbuilding Company, etc.

(4) All of the real estate of the Canda Manufacturing Company, etc.

(5) Also the entire capital stock of the Crescent Shipyard Company . . . and the business of the Crescent shipyards heretofore conducted by Lewis Nixon.

* * * * * * * *

(6) Also the entire capital stock of the Samuel L. Moore & Sons' Company. . . .

(7) Also the entire capital stock of the Bath Iron Works . . . and of the Hyde Windlass Company. . . .

(8) Also 300,000 shares out of an entire issue of 300,000 shares of the capital stock of the Bethlehem Steel Company . . . engaged in the business of manufacturing and dealing in iron and steel and the products thereof.

I will also pay, or cause to be paid, to your Company $1,500,000 for working capital, and will also deliver, or cause to be paid and delivered to your Treasurer or other nominee, the following securities, viz.: $1,500,000 in par value 5 per cent, thirty-year gold bonds of United States Shipbuilding Company, the same to be held as Treasury assets and disposed of for working capital or other purposes of the Company as your Board of Directors shall hereafter determine.

It is a further condition of this offer that in cases where your Company shall acquire both capital stock and properties of any of the corporations included in this offer, you shall guarantee, or otherwise assume, any promissory notes or other obligations which it may be necessary or desirable to put into the treasuries of such corporation or corporations for the protection of their creditors, or to avoid violation of the statutes of any state or states.

I will accept in full consideration for the conveyances . . . above offered to be made $19,998,500 in par value of the full paid and non-assessable preferred stock of your Company, $24,998,500 in par value of the full paid and non-assessable common stock of your Company, $16,000,000 par value of the first mortgage five per cent sinking fund thirty-year gold bonds, Series A, of your Company secured by a mortgage which will be a first lien upon all the property and plants of the Union Iron Works, etc. (above named companies); also $10,000,000 par value of the 5 per cent twenty-year gold bonds to be made by your Company and to be secured by a mortgage upon the shares of stock of the Bethlehem Steel Company and otherwise, as hereinafter stated.

In case you accept the offer of the stock of the Bethlehem Steel Company the purchase must be made upon the following conditions:

(1) The stock . . . is to be deposited with the New York Security & Trust Company under a mortgage or deed of trust which shall be a first lien upon the stock so acquired, and, subject to the priority of the mortgage to secure said $16,000,000 of bonds, shall be a lien upon the property and plants covered by said $16,000,000 mortgage. . . . The holders of each $1,000 par value of said bonds to have the same voting power as the holders of each $1,000 par value of the stock of your Company.

(2) For the purpose of further securing said issue of $10,000,000 of bonds, your Company shall also procure to be executed and delivered to the New York Security & Trust Company, the single bond of the Bethlehem Steel Company payable to said Trust Company for the sum of $10,000,000 gold coin, with interest thereon at the rate of five per centum . . ., conditioned for the due payment of the principal and interest of said issue of $10,000,000 of bonds, etc.

(3) That an agreement shall be executed between the Bethlehem Steel Company and your Company, by which said agreement your company shall undertake to guarantee so long as any of said issue of $10,000,000 bonds are outstanding, that the Bethlehem Steel Company shall pay dividends upon its capital stock at the rate of Three Dollars per share per year, aggregating an annual dividend contribution of $900,000, and for that purpose that your Company will supply and furnish said Bethlehem Steel Company . . . business and . . . means of earning to enable it to pay said annual dividends . . . or advance sufficient money . . . to make such annual dividend payments which may be credited on any business or work which said Bethlehem Steel Company may thereafter have for or on account of your Company. Said agreement shall further provide that so long as any of said issue of $10,000,000 bonds remain outstanding, said Bethlehem Steel Company shall be protected in keeping on hand and maintaining cash or cash assets of not less than $4,000,000 cash value over and above its current business liabilities (not including its present and projected issue of bonds) as its working capital, no part of which shall at any time be used or applied towards the payments of dividends or for purposes other than the operation and conduct of the business of said Bethlehem Steel Company.

(4) That so long as any of said $10,000,000 bonds are outstanding said Bethlehem Steel Company shall always remain an independent and distinct corporation, and shall not be merged in or consolidated . . . unless . . . requested or consented to by the holders of not less than 75 per cent of said outstanding bonds.

(5) That your Company may at any time pay all of said outstanding bonds as an entirety by depositing a sum equal to the par value . . . with interest . . . to the New York Security & Trust Company as trustee.

I will cause to be delivered to your Company suitable deeds, bills of sale and transfers, etc.

*　*　*　*　*　*　*　*

(Signed) JOHN W. YOUNG.

Upon the receipt of this offer the directors above named, holding no stock whatever in the Company, but at most a mere subscriptive right, by assignment, to one share each, adopted the following resolution:

ACCEPTANCE BY COMPANY

Whereas, John W. Young has offered to convey, sell, etc., . . .; and,

Whereas, In the judgment of this Board the value of the properties so offered . . . is at least the par value of the stocks and bonds of this Company proposed to be issued therefor, to wit, the sum of $70,997,000, and said properties are necessary for the business of this Company;

Resolved, That said offer be and the same is hereby accepted, etc., . . .

Further resolved, That for the purpose of enabling this Company to accept the foregoing offer, it shall as soon as practicable take the steps required by law for the increase of its authorized capital stock from thirty shares of $100 each . . . to four hundred and fifty thousand shares of $100 each, two hundred thousand shares of which shall be preferred stock, and two hundred and fifty thousand shares of which shall be common stock, making a total authorized capital stock of $45,000,000. . . .

Further resolved, That the officers of this Company be, and they hereby are authorized and directed to make . . . to the Mercantile Trust Company as Trustee, a mortgage or deed of trust upon the properties purchased pursuant to the offer of said John W. Young (exclusive of the shares of stock of the Bethlehem Steel Company), to secure the payment of $16,000,000 par value of first mortgage 5 per cent thirty-year sinking fund gold bonds, etc., . . .

Further resolved, That the proper officers of this Company be and they hereby are authorized and directed to make . . . a mortgage or deed of trust to the New York Security & Trust Company as Trustee, of the shares of the capital stock of the Bethlehem Steel Company . . . to secure the payment of $10,000,000 par value of the 5 per cent twenty-year gold bonds of this Company, which mortgage shall contain the provisions required under the terms of said offer, etc., . . .

Further resolved, That the officers of this Company are hereby authorized to execute, issue, and deliver to the said Young . . . the first mortgage . . . gold bonds of this Company of the aggregate par value of $16,000,000, . . . $10,000,000 and certificates for 199,985 shares of the preferred capital stock . . . and for 249,985 shares of the common capital stock, etc.

Increase of Capital Stock

On the same day, to wit, the twenty-fourth day of June, . . . a meeting of the stockholders of said Company was held for the purpose of authorizing and increasing the capital stock of the United States Shipbuilding Company and of considering and acting upon the offer of said John W. Young. There were present Frederic K. Seward, Louis B. Dailéy, Kenneth K. McLaren, Horace S. Gould, Howard K. Wood, and Raymond Newman, claiming to be holders of fifteen shares of preferred and fifteen shares of common stock of the United States Shipbuilding Company, being all the capital stock of said Company. At this meeting the following resolution was adopted:

Resolved, That the action of the Board of Directors . . . be . . . approved, ratified, and confirmed, etc.

At a meeting of the Board of Directors of the United States Shipbuilding Company held on July 31, 1902, the following resolution was adopted:

The Board of Directors, etc., do hereby resolve and declare that it is advisable that the capital stock of this Company be changed from thirty shares . . . to four hundred and fifty thousand shares . . . of capital stock, etc.

* * * * * * * *

Purchase of Subsidiary Plants

Between the fifth day of August, 1902, and the twelfth day of August, 1902, in evident compliance with the offer of said John W. Young and the acceptance thereof . . . the companies . . . conveyed to the United States Shipbuilding Company all their real and personal property. . . .

* * * * * * * *

Leases to Subsidiary Companies

Your Receiver further reports that after the delivery of said deeds . . . leases were entered into between the United States Shipbuilding Company and the (various companies hereinbefore named). . . . By the terms of these leases "all the yards, docks, and plant," etc., were leased to the above named constituent companies "at the yearly rent or sum of the net profits of the said party of the second part in its business during the term of this lease." . . . In the Union Iron Works lease the entire plant and property were leased for one year to the Union Iron Works for the nominal rental of one dollar. All such leases were terminable on five days' notice.

Alleged Basis of Directors' Actions

The resolution of the Board of Directors of the United States Shipbuilding Company accepting the offer of John W. Young, above set forth, was stated by said Board in its minutes to be based upon a report in writing from Messrs. W. T. Simpson, Fellow Institute Accounts, New York, and Riddell and Common, Chartered Accountants, on the condition of the business of the several companies mentioned in said offer, excepting the Bethlehem Steel Company. This report is alleged to have certified, among other things, that the contracts of the constituent companies for construction then in hand amounted to over thirty-six millions of dollars. That the time necessary to complete the work contracted for averaged about eighteen months from January first, nineteen hundred and two, and that the estimated net profits thereon had been calculated at over five millions of dollars. That new work was being constantly offered, and this new work, replacing completed contracts from time to time, should result in the realization of an average annual profit on work in hand and in sight of two million two hundred and twenty-five thousand dollars.

With reference to the Bethlehem Steel Company, the minutes of the Board of Directors recite that Messrs. Jones, Cæsar & Company, chartered accountants, had been investigating the affairs of the Bethlehem Steel Company, and had made a report

that the company was earning at the rate of one million eight hundred thousand dollars per year; that it had a working capital of over four millions of dollars, and that it had contracts in hand sufficient for its full running capacity for three years. In reliance upon these alleged reports, and without knowledge of, or investigation into, the merits of the properties, the resolution in question was adopted.

Acts of the Directors

A comparison of the figures alleged to have been relied upon by the Board of Directors in accepting the offer of John W. Young, with the true figures ascertained from an examination of the subsidiary companies subsequent to the purchase of said plants, discloses so great a variance as to impel the belief that the figures contained in the minutes were wilfully misstated. It is extremely doubtful whether any report was submitted by any accountants made as of that time, as the minutes recite. In a certain Prospectus marked "Private and Confidential," bearing date the 19th day of April, 1902, there is contained a letter purporting to be signed by Messrs. Simpson and Riddell and Common, under date of January 24th, 1902, which letter would seem to serve as a basis to a certain extent for the allegation in the minutes of the Board of Directors. If the examination of these accountants was made as of January 1st, 1902, as the letter would imply, it must have been of the most superficial kind. The letter in question makes such exaggerated representations with reference to the profits, present and prospective, as to make it absolutely worthless as a guide in ascertaining the real condition of the plants. It is entirely refuted by their later reports and detailed statements made as of June 30th and July 31st, 1902.

Your Receiver has seen and inspected the statements made by these accountants as of June thirtieth, nineteen hundred and two, and July thirty-first, nineteen hundred and two, and finds nothing therein to support the statements contained in the minutes of the Board of Directors.

The statement of Messrs. Simpson and Riddell and Common of the condition of the subsidiary plants as of June thirtieth, nineteen hundred and two, contains, among other things, the following figures:

1. Contract price	$34,377,408.70
2. Value of work done under said contracts up to June 30, 1902 .	13,771,768.96
3. Value of work to be done under said contracts subsequent to June 30, 1902	$20,605,639.74

The report of these accountants also contained a statement of the volume of business done by the constituent companies for the three years ending June thirtieth, nineteen hundred and two, on which the profit was shown to be about ten per cent. The report also shows that the contracts remaining unfinished on June thirtieth, nineteen hundred and two, would require three years for their completion.

From this report the following facts clearly appear:

1. That the amount of contracts on hand June thirtieth, nineteen hundred and two, instead of being Thirty-six Millions of Dollars, as recited in the minutes of the Board of Directors, was $15,394,360.26 less than the amount therein stated.

2. That it would take three years to earn whatever profit was involved in these contracts, instead of eighteen months, as alleged in the minutes.

3. That the profits on such contracts, instead of amounting to $5,000,000, as the minutes recite, basing the estimate upon the past earnings contained in the report, would be about two millions of dollars; and,

4. That the statement that the average annual profit on work in hand and in sight of the constituent companies, exclusive of the Bethlehem Steel Company, was $2,225,000, appears to have no more substantial basis than the wildest conjecture.

AMOUNT OF CONTRACTS, JULY 31, 1902

Your Receiver has caused to be prepared a statement showing the contracts in force on the 31st day of July, 1902, the portion thereof completed, the balance remaining uncompleted, and the estimated profit thereon, based upon the highest possible estimate of earnings, which is annexed hereto marked "Schedule No. 2," and made a part thereof. From this statement it appears that the face value of the contracts on hand, including extras, on July 31, 1902, was	$34,097,739.23
The value of work done on said contracts up to July 31, 1902, was .	14,295,195.15
Leaving the value of the uncompleted work on said contracts on July 31, 1902	$19,802,544.08

Estimated Earnings on Such Contracts

Adopting the figures of the accountants and estimating profit on the basis of percentage of completion reported by them and the actual cost of such percentage, the highest possible estimate of earnings on the balance of the contracts to be completed would be $2,203,269.83, as appears from said "Schedule No. 2."

An examination of the books of the Company, however, with care and the exercise of some intelligence, and adjusting the amount of the contracts at corrected figures, would have shown that there was no basis for the foregoing figures, but that there might be justification for an estimated profit of $1,660,021.59, as appears from the statement hereto annexed, made a part hereof and marked "Schedule No. 3."

An examination as of August 1, 1903, however, with the past year's work as a basis, and allowing for changes in extras, discloses another set of figures and shows that the profit on such uncompleted contracts cannot exceed the sum of $1,078,261.42, as appears from the statement hereto annexed, made a part hereof and marked "Schedule No. 4."

From this latter Schedule, which is based upon the actual cost of the work, so far as ascertainable, a situation is disclosed so much at variance with the figures alleged to have been relied upon by the Board of Directors as to lead to the belief that the minutes of the Board of Directors in this respect must have been wilfully falsified. The Five Millions of profits dwindle to about One Million; the contracts therein referred to will not be completed for upwards of three years, and, judging from past experiences, it is safe to say that this estimated profit will suffer great depreciation before the completion of the contracts.

Working Capacity of Plants in Relation to Earnings

So far as your Receiver is able to ascertain, the full capacity of the yards, exclusive of the Bethlehem Steel Company, is about fourteen million dollars of work annually, while twelve million dollars is an average volume of work. From the figures contained in the report of the Messrs. Simpson and Riddell and

Common, it appears that the average profit of the yards for the three years preceding their purchase by the United States Shipbuilding Company did not exceed ten per cent. Upon this basis the average annual profit derived from the yards, on the basis of the capacity above stated, would not exceed a million four hundred thousand dollars.

Earnings for the Year ending August 1, 1903

This basis, however, is no guide to the actual earnings of the constituent companies. After being in operation for one year under the control of the United States Shipbuilding Company, the earnings of the constituent companies, exclusive of the Bethlehem Steel Company, instead of being $2,225,000, as alleged by the Directors, or $1,400,000, as figured on the above basis of ten per cent, did not exceed $833,458.74, as appears from "Schedule 5," hereto annexed and made a part hereof.

It has been suggested that the poor showing in regard to earnings is due to the increased cost of labor and material during the past year. It is true that the cost of labor was greater during the past year than the previous years, and that there were some losses occasioned by strikes; but it is also true that, by reason of the combination of all the yards under one management and the attempted control thereof by the United States Shipbuilding Company, there should have been a great reduction in the management expenses. This reduction in expense, however, did not come to pass, and one reason for it may be found upon an examination of the offer of Young, above set forth. In this offer it will be found that in the case of the Union Iron Works, Eastern Shipbuilding Company, Samuel L. Moore & Sons' Company, Bath Iron Works, and the Hyde Windlass Company, it was provided that the United States Shipbuilding Company should enter into contracts with certain persons therein named for upwards of five years at salaries, in many instances, greater than the earnings of the subsidiary company would warrant. The acceptance of this offer, therefore, with these conditions imposed, not only reduced the earnings of the subsidiary companies, but left the officers in charge

thereof practically free from interference by the Board of Directors of the United States Shipbuilding Company for a period of five years, a fact that must necessarily have had considerable influence upon the management and earnings of the individual plants. This fact, however, does not wholly explain the failure of the earnings of the constituent companies to reach the amount of earnings estimated in the preliminary reports. The real reason why the earnings fell below the anticipated profits was because previous alleged earnings had been figured upon a percentage of completion of contracts, which percentage in many instances was erroneous. For instance, in the case of the torpedo boats "Nicholson" and "O'Brien," it was stated that these boats were fully completed As a matter of fact there was subsequently expended thereon the sum of $56,271.04, and it is estimated that upwards of $20,000 is still needed to complete these boats. Your Receiver, therefore, respectfully submits that the method of arriving at profits earned previous to the combination was practically worthless for the purpose of ascertaining accurate results, and led to the inaccuracies in the estimates for the future.

Bethlehem Steel Company

In regard to the Bethlehem Steel Company, the minutes of the Board of Directors with reference to the offer of the said Young, recite that an investigation of the affairs of that company discloses that it was earning at the rate of $1,800,000 a year, and that it had a working capital of over $4,000,000. For the two years preceding the adoption of the resolution in question by the directors the earnings of the Bethlehem Steel Company for the fiscal year ending the thirtieth day of April were as follows:

1900–1901	$381,403.83
1901–1902	978,743.81

From these figures, as to the earnings of the Bethlehem Steel Company, which are made up from the report submitted by the Bethlehem Steel Company, it appears that the earnings of that company at the time of the adoption of the resolution were much below the amount alleged in the minutes of the Board of

Directors of the United States Shipbuilding Company, and that there was then no justification for the use of such figures.

It also appears that the working capital of the Bethlehem Steel Company at the close of their fiscal year on the thirtieth day of April, nineteen hundred and two, was not over $4,000,000, but was at least $250,000 less than such amount, as hereinafter set forth.

WORKING CAPITAL

From the report of Messrs. Simpson and Riddell and Common, as of July 31st, 1902, not made, however, until after the properties had been acquired and paid for, it appears that the working capital of the constituent companies, exclusive of the Bethlehem Steel Company, was $3,278,798.48. The figures making up this total were subsequently found to be excessive in the case of nearly every company, the shrinkage amounting to $1,450,367.41, so that the working capital of the constituent companies was but $1,828,431.07, as appears from the statement hereto annexed, marked "Schedule No. 6," and made a part hereof. From the statement hereto annexed, marked "Schedule No. 7," and made a part hereof, it appears that with the exception of the Union Iron Works, the subsidiary companies, taken together, had absolutely no working capital; but on the contrary their liabilities exceeded their resources in the sum of $294,719.33. By reference to this schedule it appears that the following was the condition of said companies at the time of their purchase:

DEFICIT		
Bath Iron Works	$3,518.74	
Crescent Shipyard Company	403,192.28	
Harlan & Hollingsworth Co.	73,813.44	
S. L. Moore & Sons' Company	5,039.27	
		$485,563.73
SURPLUS		
Eastern Shipbuilding Company	$1,391.34	
Hyde Windlass Company	189,453.06	
		$190,844.40
Net Deficit being excess of Liabilities over Assets		$294,719.33

From an examination of "Schedules 6 and 7," it will appear that the alleged working capital was provided largely by the

Union Iron Works, with slight help from the Hyde Windlass Company and the Eastern Shipbuilding Company.

The amount of Accounts Payable and Notes Payable of the different companies at the time of their purchase by the United States Shipbuilding Company was $2,334,987.64. Of this amount $2,192,145.98 was owing by the subsidiary shipbuilding companies other than the Union Iron Works, as appears from said "Schedule No. 7." As the principal part of the alleged working capital above mentioned was confined to Union Iron Works, it will appear that so far as the remaining companies are concerned, when taken over by the United States Shipbuilding Company, they not only had no working capital, taken collectively, but were in immediate need of financial assistance.

From the foregoing facts, viewed not only in the light of subsequent developments, but also from the figures obtainable at the time of the incorporation of the United States Shipbuilding Company, it appears to have been the intention of those responsible for the statements and figures alleged to have been relied upon to mislead and deceive the investing public and the then present and future creditors of the Company.

Prospectus

In this connection, your Receiver begs to refer to the prospectus issued to the public, with a view to inducing subscriptions for the bonds of the United States Shipbuilding Company, under date of June 14, 1902. This prospectus seeks to invite the public to subscribe for nine millions of dollars of the first mortgage 5 per cent sinking fund gold bonds of the United States Shipbuilding Company. It recites that the United States Shipbuilding Company "has been organized under the laws of the State of New Jersey." It implies that the total capital stock of the Company is twenty millions of dollars, $10,000,000 of which is preferred and $10,000,000 common. It sets out a list of the directors of the United States Shipbuilding Company, numbering ten in all. It recites that the subsidiary plants of the Company, exclusive of the Bethlehem Steel Company, have been appraised as going concerns at twenty millions of dollars ; that

these companies would have a combined working capital of more than five million of dollars; that they have on hand contracts for work amounting to more than $36,000,000, on which the profits were estimated at over $5,000,000.

Waiving for the present all discussion as to the value of the plants as going concerns, a comparison of this prospectus with the facts disclose the following false and misleading statements:

1. At the date of this prospectus the United States Shipbuilding Company had not been incorporated.

2. Its capital stock was never Twenty Millions. Originally it was Three Thousand Dollars; which amount was subsequently increased to Forty-five Millions.

3. Six of the ten persons mentioned as directors in the prospectus were not directors of the company, and never have been.

4. The amount of contracts on hand did not exceed $36,000,000, their face value being $34,182,861.94, but of this amount a profit was available only on the uncompleted portion of the contracts, which profit, as heretofore shown, will not exceed $1,078,261.42, and will take three years to earn.

5. These companies did not have a working capital of more than $5,000,000; the figures of the accountants show only a working capital of $3,278,798.48. This working capital, however, was almost obliterated by subsequent adjustment, as hereinbefore set forth.

6. The statement that the profits on contract work in hand would be $5,000,000 was undeniably false. If it is claimed that the profit was estimated on the entire amount of $36,000,000, the answer to this is that, admitting there was $36,000,000 worth of contracts (which was not true), the utmost profit that could be looked for, according to the figures of the accountants, was $3,600,000. When this prospectus was issued, the persons who were responsible for it must have deliberately disregarded figures which would have shown that the amount of work still to be done on the contracts was but $20,605,639.74, instead of $36,000,000, and that upon such uncompleted work a liberal estimate would have placed the earnings at only a trifle over $2,000,000.

Value of the Plants

The net surplus of the various constituent companies, including their plants, according to the statement of the accountants, as shown by the books of said companies, were on the 31st day of July, 1902, as follows:

Bath Iron Works	$827,316.19	
Hyde Windlass Co.	358,121.29	
Crescent Shipyard Co.	470,583.99	
Samuel L. Moore & Sons' Co.	404,788.88	
Eastern Shipbuilding Co	237,278.53	
Harlan & Hollingsworth Co.	1,294,767.16	
Union Iron Works	4,303,378.97	
Total	$7,896,235.01	
Bethlehem Steel Co. (deducting underlying mortgages)	4,245,281.25	
Canda Manufacturing Co. (estimated)	300,000.00	
Total		$12,441,516.26

For this property the directors of the United States Shipbuilding Company parted with the following obligations of that company:

Preferred stock of the U. S. S. Co.	$19,998,500	
Common stock of the U. S. S. Co.	24,998,500	
First mortgage 5 per cent bonds	16,000,000	
Twenty-year gold bonds	10,000,000	
Total		$70,997,000.00

There was returned to the company, however, the following cash and securities:

Cash	$1,500,000	
First mortgage bonds	1,500,000	
Total		$3,000,000.00
Total bonds and stock paid by Shipbuilding company's directors for the subsidiary plants		$67,997,000.00

In connection with the purchase of the Canda Manufacturing Company, $1,100,000 of the cash and securities of the United States Shipbuilding Company were parted with. The Canda company gave up nothing except its lands and buildings, its good will, if any, and practically all of its machinery being retained by the vendors. The above estimated value of $300,000 is undoubtedly greatly in excess of its true value. No use has

ever been made of this plant, and none was apparently contemplated when it was purchased. After its purchase the directors of the United States Shipbuilding Company caused an inquiry to be made with a view to ascertaining whether it could be put to any use, and an adverse report was made. (See minutes of the directors.) Why this property was purchased at all is not apparent.

Viewing the acquisition of the properties from the standpoint of the surplus and plant values, as disclosed by the books of the companies, the directors appear to have made a gift of upwards of $55,000,000 worth of stock and bonds of the United States Shipbuilding Company entrusted to their care.

It may be claimed, however, that the book values give no adequate idea of the real value of the plants as going concerns, and that the earnings of the plants should be taken into account in ascertaining such value. With reference to this matter, the minutes of the directors recite that the constituent companies, exclusive of the Bethlehem Steel Company, had an earning capacity annually of	$2,225,000.00
and that the Bethlehem Steel Company was earning	1,800,000.00
Making a total earning capacity of	$4,025,000.00

This statement was false, and must have been known to be so at the time the plants above mentioned were taken over. It can serve no useful purpose, therefore, in establishing value from the standpoint of earning capacity. In this connection the earnings of the past year are presented for consideration:

The earnings of all the companies for the year ending July 31st, 1903, were as follows:

Constituent companies	$833,458.74
Bethlehem Steel Company (net earnings) after deducting interest on underlying mortgages, discounts, and depreciation	1,662,530.80
Total	$2,495,989.54

A word of explanation with reference to the earnings of the subsidiary shipbuilding companies. These earnings, as to continuing contracts, are arrived at as follows: An estimate is made of the proportion of the contract completed. If this proportion should represent 50 per cent of the entire contract, and the actual cost of such percentage should be found to be 10 per cent less than the proportion of the entire contract price then earned, the profit, when such estimate is made, is put down at a figure which

will represent 10 per cent of such earned proportion of the contract price. Frequently this method of arriving at profits is found to be erroneous. The percentage of completion is found to have been placed too high, and as a consequence, the profits on the entire contract are reduced much below the estimate, and, in many cases, entirely wiped out and a loss sustained.

With reference to the Bethlehem Steel Company, a different method prevails. The method of the latter company is to take profits only upon deliveries, and not to estimate earnings as the work progresses. By this method the actual profits may be arrived at.

Assuming, however, that the earnings of the constituent companies are correctly set forth above (and in the case of Bethlehem they are not understated), of what use are such earnings for the purpose of establishing values unless they are available by the United States Shipbuilding Company?

These companies claim to have earned $2,495,989.54, but the United States Shipbuilding Company has been benefited to the extent only of a trifle over twelve per cent of this amount. Of these alleged earnings the constituent companies have paid during the eleven months ending July 1, 1903, to the United States Shipbuilding Company	$60,754.23
The Bethlehem Steel Company, for the purpose of meeting the semi-annual interest on the $10,000,000 mortgage	250,000.00
Making a total of	$310,754.23

Of the $833,458.74 alleged to have been earned by the Shipbuilding companies, there has been expended for new machinery . .	$165,066.38
Of the earnings of Bethlehem company there was expended for plant betterment	683,370.24
There was paid by all of the companies to the United States Shipbuilding Company, as above stated	310,754 23
Making a total of	$1,159,190.85

The balance of the earnings (considering the above amount as having been earned) amounting to the sum of $1,336,798.69, was retained by the companies. By reason of the unsafe method of ascertaining the profits of the shipbuilding companies, it is extremely doubtful whether they have earned any such amount as above set forth. It is true, however, assuming that their earnings have been as above mentioned, that their financial condition has not been such as to warrant them in withdrawing any consider-

able sum from their assets for payment to the United States Shipbuilding Company. The utmost that they could do during the past year was a trifle over seven per cent of the amount claimed by them to have been earned The Bethlehem company, during the past year, insisted that no sum in excess of the $250,000 paid by them to meet the interest on the $10,000,000 instrument, known as the Schwab mortgage, could be withdrawn from their assets for payment to the United States Shipbuilding Company; or, in other words, that about fifteen per cent of their entire earnings was the best they could do for the United States Shipbuilding Company. Concerning the earnings of the Bethlehem, your Receiver will deal at length elsewhere in this report, but it may be said here that Bethlehem deliberately used up its earnings in making enormous purchases of material for its own benefit, and in extensions, improvements, and repairs, in order apparently to keep its earnings from the United States Shipbuilding Company.

On the basis of what the United States Shipbuilding Company received from all the companies last year, there would be sufficient income only to meet the interest, at five per cent, on an investment of a trifle over $6,000,000. It may be insisted that this is not the best the companies can do, and therefore this amount should not be taken as a guide in establishing the value of the plants. Your Receiver is satisfied that it is not the best the companies can do, especially in the case of Bethlehem. It is certain that better returns would have been received from the constituent companies if they had been brought within closer reach of the central company, and if officers had been placed in charge who had looked to the interests of the central organization and not wholly to the betterment of the constituent companies. It is undoubtedly true that the fastening upon the constituent companies of certain officials, at fixed salaries, and for a long term of years, practically beyond the reach of the central organization, has materially prevented the United States Shipbuilding Company from obtaining the best results from its properties. In the case of the Bethlehem, a Board of Directors having the welfare of the United States Shipbuilding Company at heart, rather than its destruction, would have conduced much to the gain of the latter company. With these defects in man-

agement removed, the earning capacity of all the companies, so far as the United States Shipbuilding Company is concerned, would be greatly enhanced.

At the end of eleven months of operation, the United States Shipbuilding Company was adjudged insolvent and a receiver appointed. This was due either to the fact that the earnings were insufficient to meet its obligations, or because those earnings were improperly diverted. Your Receiver will hereinafter discuss this matter, but under this head he respectfully submits that the earnings of the several companies during the past year may not safely be used for the purpose of establishing the value of the plants.

Excessive Price paid for Plants

Considering the value of the plants, therefore, either from the standpoint of the books, or the earning capacity of the companies, and allowing for an increase in earnings in the future, it is evident that the accommodating directors of the United States Shipbuilding Company, in acquiring these properties, deliberately gave away many million dollars in the stock and bonds of their Company.

Who participated in this wholesale plunder? The testimony now being taken in the above entitled proceedings will doubtless disclose the name of all the participants; but as such testimony will be submitted to this Court for action, your Receiver does not deem it proper to comment upon it here. Certain it is that much of this vast amount of stock and bonds was taken by persons and corporations who parted with little or no consideration in exchange therefor. Blocks of the stock went to the vendors of the constituent plants and to the purchasers of bonds, as bonus, absolutely without benefit to the Company; $20,000,000 of it admittedly went to Mr. Charles M. Schwab in addition to the agreed price for Bethlehem. Some of it went to the promoters of this artistic swindle; and when all had been provided for, what was left of the bonds, amounting to $1,500,000, was handed back to the Company ostensibly to supply it with "working capital."

From the foregoing statement as to values, it is apparent that the $24,500,000 of bonds given up by the directors was an excessive price for all the plants purchased. Your Receiver is advised that as to the $44,997,000 of the preferred and common stock handed over by the directors to the vendors and promoters of this scheme, it cannot successfully be maintained that any value was paid therefor. Treating the issue of bonds, therefore, as full payment for the properties (and in so doing the Shipbuilding company alone is being injured), it follows that the vendors and promoters and their associates in the transfer and conveyance of the various plants to the United States Shipbuilding Company, by the acceptance of this $44,997,000 of the capital stock of the Shipbuilding company, without paying value therefor, became liable thereon to said corporation, by virtue of the provisions of section 21 of an act of the Legislature of the State of New Jersey, entitled an act concerning corporations (Revision of 1896). The United States Shipbuilding Company was entitled to recover such indebtedness from the holders of such stock and your Receiver is advised that he is entitled to enforce the same. Accordingly, your Receiver has offset against the sum alleged to be due on the $10,000,000 mortgage to the New York Security and Trust Company as trustee, to protect the issue of bonds to Charles M. Schwab, the liability of the said Charles M. Schwab on the $20,000,000 of stock received by him as aforesaid, and has interposed an answer in the suit by said trustee to foreclose the mortgage given as security for said bonds, claiming that by virtue of said offset the total issue of said bonds has been fully paid and satisfied. As to the issue of the bonds under the mortgage for $16,000,000 made to the Mercantile Trust Company, your Receiver charges that many of said bonds were received by the vendors and promoters and their transferees, and were issued by said Mercantile Trust Company, with full knowledge of the right of the United States Shipbuilding Company to be paid for the common and preferred stock taken by said vendors and other holders of said bonds without value, and as to all bonds secured by said mortgage so received, your Receiver has offset against the amount alleged to be due thereon, the liability of the holders thereof on the com-

mon and preferred stock so received by them, or their transferrers, and has interposed an answer in the suit instituted by the Mercantile Trust Company to foreclose said mortgage, claiming that by virtue of such offset the total issue of said bonds, or the principal part thereof, has been fully paid and satisfied.

Culpability of the United States Shipbuilding Company's Directors and Others

Your Receiver has spoken of the directors of the United States Shipbuilding Company as if they were wholly responsible for parting with many million dollars in the stocks and bonds of the United States Shipbuilding Company without value. The directors who were guilty of this act are responsible and should be held accountable for their unlawful act; but they are not alone responsible. In the first place, they were not bona-fide holders of the stock of the United States Shipbuilding Company. They were clerks selected by the promoters of this scheme from the Corporation Trust Company. They took an assignment of a subscriptive right to a share of stock, and upon the strength of this alleged subscription they dealt with the property of the United States Shipbuilding Company in the manner above recited. These young men were mere figureheads, placed in this position in order that the scheme of others might be carried into effect. This scheme was placed before them by its instigators, through the medium of an alleged offer of John W. Young, and the so-called directors in conformity with their instructions, and, without the ability or the knowledge to pass upon the matters therein contained, proceeded to do as they were told. Your Receiver charges that the properties of the various constituent companies were sold to the United States Shipbuilding Company for an amount which the vendors of such properties, at the time of such sale, knew to be far in excess of the fair value of said plants; and that the plan to combine such properties was conceived by certain promoters and was consummated by them with full knowledge of its injustice to the United States Shipbuilding Company.

Your Receiver begs to direct the attention of the Court to the

fact that in the purchase of the various constituent companies, the United States Shipbuilding Company was absolutely without independent and intelligent representation. No inspection of the properties was made on behalf of the Shipbuilding company. No independent appraisement was had. No steps seem to have been taken by any one with a view to protecting the interests of the United States Shipbuilding Company. The directors who purported to act for the Company were the tools of the promoters; the debts of the constituent companies, aggregating $2,334,987.64, seem to have been purposely withheld, and the bonds and stock of the United States Shipbuilding Company were placed wholly at the mercy of the vendors and promoters.

Operation of the United States Shipbuilding Company

Under such auspices the United States Shipbuilding Company began operations. On paper the constituent companies had a working capital in excess of $3,000,000, yet offices had hardly been secured by the United States Shipbuilding Company before the latter company was compelled to assist the constituent companies to pay their debts. The alleged working capital of the constituent companies existed on paper only. It was made to appear as available capital in order that the sale might be consummated. After such sale there was no longer any necessity for the continuance of this pretence, and accordingly demands for remittances began to pour into the central organization. During the eleven months ending July 1, 1903, the United States Shipbuilding Company was compelled to advance to the constituent companies the sum of $1,019,955.78. Of this amount $60,754.23 was returned to the Company, making the net amount advanced to the constituent companies $959,201.55. In addition to this sum it was compelled to part with $520,000 of the bonds which had been placed with it as working capital, for the purpose of securing indorsements on promissory notes which the United States Shipbuilding Company was required to make for the accommodation of the constituent companies.

The reason for this has been herein elsewhere suggested. When the various properties were purchased, the debts of such

companies were not disclosed. Had there been independent, intelligent representation on the part of the United States Shipbuilding Company in connection with the acquisition of these properties, it would have been discovered that the new company was taking over $2,334,987.64 of debts, a considerable part of which called for immediate attention. Had there been such representation, it would have been disclosed that the companies had practically no working capital except such as they might receive from their vendee, and with this knowledge the wholesale delivery of bonds and stocks of the United States Shipbuilding Company would undoubtedly have been averted. But there was no one in that transaction to protect the interest of the new company, and as a consequence it was not only made to pay excessive prices for the property purchased, but obligations were assumed by reason of this vast amount of debt that practically exhausted the resources of its treasury.

While the bills of sale from the various constituent companies purported to transfer all the personal property of such companies to the United States Shipbuilding Company, including their cash, amounting to the sum of $389,317.57 (exclusive of Bethlehem), this amount was retained by the various companies when the leases above mentioned were made, and no benefit therefrom was ever received by the United States Shipbuilding Company, except the doubtful one of allowing this amount to help swell the alleged working capital of the constituent companies.

The United States Shipbuilding Company was not fairly organized until some time in September, 1902. On the 24th day of December, 1902, with a view to inducing the New York Stock Exchange to list the entire stock and bond issue of the Company, amounting to $69,500,000, a statement was made to such exchange, over the signature of A. C. Gary, treasurer of the United States Shipbuilding Company. This statement recites that the earnings of the subsidiary companies, exclusive of the Bethlehem Steel Company, for the year ending June 30, 1902, amounted to the sum of $1,942,522.03, and that the net earnings of the Bethlehem Steel Company for twelve months ending July 31, 1902, amounted to the sum of $1,441,208.03.

Without taking time to controvert this statement, which was clearly erroneous, and which, upon a proper examination, would have been shown to be so, an allegation appears in this statement of far more serious import. It is therein alleged that the net earnings of the United States Shipbuilding Company and the Bethlehem Steel Company for the three months ending November 30, 1902, amounted to the sum of $1,163,022.22. Of this amount the United States Shipbuilding Company was said to have earned up to that time $554,021.45, and the portion earned by the Bethlehem Steel Company was placed at $609,000.77. These earnings were said to be net; but in the case of the Bethlehem Steel Company no allowance was made therein for depreciation, and, furthermore, such earnings constituted no basis for averaging the annual profit, as the later report of the Bethlehem Steel Company shows. In the case of the United States Shipbuilding Company, the earnings existed on paper only, as appears from subsequent reports. Your Receiver believes that the officials of the United States Shipbuilding Company did not know that erroneous reports were being made to them by the constituent companies, but their action was at least injudicious in so wording the statement to the Stock Exchange as to impel the inference that the earnings of the United States Shipbuilding Company up to the 30th day of November, 1902, were available for the purpose of meeting the accrued interest and sinking fund payment on all bonds of the company for that quarter, for during the very time within which the alleged earnings of $554,021.45 had been made by the subsidiary companies, and which the statement infers were available for the payment of all accrued interest and sinking fund charges, they had been compelled to advance in cash to the constituent companies the sum of $424,467.59.

On this showing the application to list the securities was granted by the New York Stock Exchange on January 14th, 1903. A little over four months later, on the 25th day of May, 1903, a statement was issued to the public embodying a plan for the reorganization of the United States Shipbuilding Company upon a basis that would enable it to exist. This proposed plan of reorganization stated that "by reason of the excessive mortgage obligations of the United States Shipbuilding Company, its

borrowing capacity and credit has become so seriously affected that outstanding notes are being pressed for payment and the making of further loans is rendered impossible," and recommended that the Company should be reorganized upon a basis of almost 40 per cent less than was originally considered the fair value of the plants. If other evidence than the figures above set forth be needed to prove that vendors and promoters of this scheme sought to secure stocks and bonds of the United States Shipbuilding Company without consideration, it is supplied by this proposed Plan of Reorganization, which practically states that the Company is unable to pay interest on a greater capitalization and bond issue than $43,000,000, an amount $1,487,000 less than the capital of the United States Shipbuilding Company distributed in connection with the purchase of the properties, to say nothing of the bond issues of $24,500,000.

Causes of Failure

What were the causes of failure of the United States Shipbuilding Company? One of such causes was the fact that the directors parted with bonds to an amount upon which it was impossible to meet the interest. The failure, however, was precipitated, if not directly brought about, by the fact that in the Bethlehem transaction the United States Shipbuilding Company officers had to deal with people who, while thoroughly understanding the intricacies of "higher finance," seemed to have overlooked the requirements of common fairness. In speaking of plant values elsewhere in this report, the Bethlehem property has been dealt with as though it had been purchased by the United States Shipbuilding Company, but an examination of the transaction will show that it was otherwise. While the agreed price for the Bethlehem company was $9,000,000, to be paid for by an issue of $10,000,000 of bonds at 90, the directors of the United States Shipbuilding company, upon request, handed over to Mr. Charles M. Schwab an additional amount of $20,000,000 in the common and preferred stock of the United States Shipbuilding Company. As this $20,000,000 of stock would not be sufficient to give Mr. Schwab the control of the United States

Shipbuilding Company, there was inserted in the mortgage given to secure his $10,000,000 of bonds, a provision that such bonds should have a voting power equal to $10,000,000 of stock. As the total issue of stock of the United States Shipbuilding Company was but $45,000,000, the $30,000,000 voting power thus given to Mr. Schwab was sufficient to justify him in saying that he did not sell the Bethlehem Steel Company, but took over the United States Shipbuilding Company, the directors of that Company giving him $30,000,000 in stock and bonds for taking it off their hands.

In this deal Mr. Schwab parted with nothing. In the sale of the other constituent companies, the real and personal property, as well as their capital stock, were transferred to the United States Shipbuilding Company by the necessary deeds, bills of sale, and assignments. But in the case of Bethlehem, Mr. Schwab permitted to be given up only its capital stock, and this he did in such manner as to place it beyond the control of the Shipbuilding company. If interests friendly to the United States Shipbuilding Company had controlled this stock, it would have been able to reach the earnings of the Bethlehem Steel Company through a friendly Board of Directors; but in the $10,000,000 mortgage it was provided that the Trustee should designate three of such directors, and the United States Shipbuilding Company should designate four. As Mr. Schwab controlled the United States Shipbuilding Company, by reason of his aforesaid majority of stock, and as the Trustee was of his own selection, the United States Shipbuilding Company was absolutely at the mercy of Mr. Schwab. His advisers, however, in evident fear that something had been overlooked, caused the United States Shipbuilding Company to execute a contract wherein it agreed and guaranteed that so long as any part of the $10,000,000 issue of bonds above referred to should be outstanding and unpaid, the Bethlehem company should pay dividends on its entire outstanding capital stock at the rate of not less than six per cent per annum, and for the purpose of making such payments the Shipbuilding company agreed that the Bethlehem company should earn, over and above its operating expenses and fixed charges (including interest on its bonds and taxes), and over and above the working capital of

$4,000,000 therein provided for, a sum sufficient to make such annual dividend disbursements; and, in the event of the failure of the Bethlehem company earning sufficient to pay such dividend at the rate of six per cent, then the United States Shipbuilding Company was to pay to the Bethlehem company, on demand, a sum sufficient to make such annual dividend disbursements. The Shipbuilding company further agreed to supply the Bethlehem company with all such orders, contracts, work and earning capacity as should be necessary to enable it to earn and pay the annual dividends above mentioned. Was ever such another agreement, so apparently harmless, yet so ruinous, conceived by the mind of man? On its face it was simply an agreement to the effect that if sufficient earnings were not made by the Bethlehem to pay a dividend of 6 per cent on its capital stock, the United States Shipbuilding Company would advance such sum. This agreement was an absurd arrangement, in view of the fact that the United States Shipbuilding Company was the nominal owner of this stock, and as such was entitled to its dividends; nevertheless the United States Shipbuilding Company was made to agree in effect that if it wanted dividends from Bethlehem it should contribute the means to enable the payment of such dividends. An excuse for the United States Shipbuilding Company officials entering into such an agreement might be found in the supposition that they may have believed that as they had the right to designate four of the seven directors of the Bethlehem Steel Company, they would be able to control the earnings of that company, and the agreement above mentioned might become inoperative. Such a belief, however, had no substantial foundation, for, as heretofore stated, the control both of the Bethlehem and the United States Shipbuilding Company was vested in Mr. Schwab. Your Receiver will not attempt to advance any reason why the latter thought it necessary to take any such agreement in view of the fact that he had previously thereto obtained a control of the Shipbuilding company that would enable him at any moment to throttle it. As if the foregoing provisions in said agreement were not sufficient, the United States Shipbuilding Company was further made to agree that in the event that the working capital of the Bethlehem Steel Company should at any

time fall below $4,000,000, the United States Shipbuilding Company would, upon demand, make up such sum as might be necessary to bring the working capital up to that figure. The agreement contains other provisions, all operating against the United States Shipbuilding Company, but enough has been referred to to show that in signing it the United States Shipbuilding Company had lost all chance of ever reaching the earnings of the Bethlehem Steel Company. For, assuming that Mr. Schwab's directors of the United States Shipbuilding Company should demand of Mr. Schwab's directors of the Bethlehem Steel Company that a dividend be declared from the earnings of the latter company, Mr. Schwab's directors of the Bethlehem Steel Company could always reply (as they did when demand was made) that it was not considered wise to declare a dividend at that time.

In April, 1903, it became apparent that unless funds were advanced by the Bethlehem Steel Company for the purpose of meeting the semi-annual interest on the first mortgage bonds due July 1st, a default in the payment thereof would ensue. Notwithstanding the urgent need apparent at that time for retrenchment, and the necessity for requiring Bethlehem to set aside some of its large earnings for the purpose of meeting the coming interest, the Executive Committee of the United States Shipbuilding Company, on the 7th day of April, 1903, adopted a resolution approving a report of the president of the Bethlehem Steel Company with reference to certain improvements and extensions alleged to have been required at the works of the latter company, showing a total required expenditure of $2,802,000 (including $365,000 previously appropriated). On the 14th day of April, 1903, the directors of the United States Shipbuilding Company held a meeting, at which time it was sought to approve the minutes of the previous meeting of the Executive Committee. On a motion to approve such minutes, Mr. Lewis Nixon, the president of the company, stated that he desired to go on record concerning the resolution passed, to the effect that in providing for any such extensions and improvements it should be made a condition of any such expenditure that proper provision should be made to safeguard the amount of $900,000, which must be declared as a dividend by the Bethlehem company, and

suggested that provision to that effect be added to the authority asked for. Notwithstanding this request of Mr. Nixon, the minutes of the Executive Committee were approved by the directors.

Your Receiver is informed, and believes it to be true, that thereafter Mr. Lewis Nixon repeatedly sought to induce the directors of the United States Shipbuilding Company to coöperate with him in compelling the Bethlehem company to pay over some of its earnings for the purpose of staving off the impending default of the United States Shipbuilding Company; but from the 14th day of April, 1903, until the 22d day of June, 1903, it was impossible to obtain a quorum either of the Executive Committee or of the directors of the United States Shipbuilding Company. Again, on the 27th of June, while the proceedings were pending in this court for the appointment of a Receiver, Mr. Nixon demanded the Bethlehem Steel Company's assistance for the purpose of averting the impending default, through the medium of the following letter:

NEW YORK, June 27th, 1903.

E. M. McILVAIN, ESQ.,
President Bethlehem Steel Company,
South Bethlehem, Pa.:

DEAR SIR — The Bethlehem Steel Company, having earned during the year ending August 1st, 1903, over and above its operating expenses and fixed charges (including interest on its bonds and taxes), and without impairment of its working capital of $4,000,000, a sum sufficient to pay a dividend of 6 per cent on its entire present outstanding capital stock, I request and demand, in behalf of the United States Shipbuilding Company, as owner of all of said capital stock, that your company, on or before June 30, 1903, declare a dividend in an amount sufficient to pay a bond interest of $362,500, due July 1st, 1903, and pay the same as required by the terms of the agreement of August 12th, 1902, between your company and the United States Shipbuilding Company, and credit this upon the yearly dividend on the stock of the Bethlehem Steel Company, $250,000 of which has already been declared and paid in a similar manner to meet the interest on the twenty-year bonds.

Yours truly,
(Signed) LEWIS NIXON,
President.

No attention was paid to this demand, and the default followed. Had the efforts of Mr. Nixon been successful, the subsequent adjudication of insolvency and the appointment of a receiver would have been averted.

Your Receiver considers it his duty to bring to the attention of the Court the fact that while the Bethlehem company was earning upwards of $2,000,000 annually, these earnings were being placed beyond the reach of the United States Shipbuilding Company by the making of vast extensions and improvements in the Bethlehem company and the purchasing and ordering of enormous quantities of merchandise, with the apparent purpose of bringing about the destruction of the United States Shipbuilding Company.

Further proof in this behalf is supplied by Mr. E. M. McIlvain, President of the Bethlehem Steel Company, in his letter to Mr. George R Sheldon, Chairman of the Reorganization Committee. In this letter, dated the 25th of May, 1903, Mr. McIlvain states that during the fiscal year of the Bethlehem Steel Company ending April 30th, 1903, the net earnings of his company were $2,518,264.58. In the third paragraph of this letter he states that for the year beginning May 1, 1903, a conservative estimate of the net earnings of the Bethlehem Steel Company would be about $2,250,000 after deducting $517,550 of earnings for the purpose of paying interest on the underlying mortgages. Of this amount of earnings, he states, in the fourth paragraph of his letter, that he feels confident that there could be withdrawn for distribution (for dividends) the sum of $1,200,000. During the year within which Mr. McIlvain says the net earnings of the Bethlehem Steel Company were $2,518,264.58, the utmost that the Bethlehem Steel Company could be induced to give up to the United States Shipbuilding Company was $250,000. But in presenting the matter to the public, through the medium of the Reorganization Committee, and with a view to inducing the acceptance of a plan that would further the interests of Mr. Schwab, he states that from the earnings which are not in excess of the fiscal year ending April 30, 1903, he would be able to withdraw and pay over to the reorganized company a sum almost five times as much as his company was able to do when there

was the utmost need for its greatest contribution. Your Receiver is unwilling to believe that Mr. McIlvain would deliberately make a false statement in this connection. He is also willing to accept his statement that the Bethlehem company would be able to withdraw from its current assets the sum of $1,200,000 for distribution during the year beginning May 1, 1903, but in accepting this statement and considering it in connection with the fact that all Bethlehem would advance during the past year was $250,000, and bearing in mind that the major part of the improvements and extensions above authorized were to be completed in subsequent years, it is difficult to draw any other conclusion than that the earnings of Bethlehem company during the past year were deliberately withheld for the purpose of wrecking the United States Shipbuilding Company. During the year ending July 31, 1903, Bethlehem expended for additions to its plant the sum of $683,370.24. In addition to this amount it expended for extraordinary and general repairs, during the year ending April 30, 1903, according to the report of Price, Waterhouse & Co., the sum of $450,000. It increased its material (unfinished and finished product and stores) $687,149.16. Its notes payable, which amounted to $350,000 when the stock of this company was attempted to be purchased by the United States Shipbuilding Company, were reduced $200,000 up to August 1, 1903, and have since been entirely wiped out, and finally it reduced its accounts payable to the extent of $179,468.22. Why such enormous sums should be expended for additions, repairs, and material at a time when the United States Shipbuilding Company was in urgent need of financial aid can be reasonably accounted for only upon the theory that it was in conformity with a deliberate plan to provide a plausible excuse for having withheld all dividends when the crash should come in the affairs of the United States Shipbuilding Company. Some attempt has been made by Bethlehem to justify its retention of its earnings by the statement that its credit had become impaired, and it was therefore necessary to pay cash for supplies, as well as to reduce its accounts and bills payable in order to placate its creditors. The alleged cause of the impairment of credit was said to be a mortgage for $10,000,000 which the

Bethlehem company made to the Colonial Trust Company upon its plant and property at the time of the purchase of Bethlehem by the United States Shipbuilding Company. As further security to Mr. Schwab for the $10,000,000 of bonds delivered to him as the purchase price of Bethlehem, the Bethlehem Steel Company executed to the Colonial Trust Company the mortgage above referred to to secure a bond in the like amount. Your Receiver is advised that the execution and delivery of such bond and mortgage by Bethlehem to secure Mr. Schwab for the purchase price of the sale of the stock of the Bethlehem was a fraud upon the creditors of said company, and was otherwise void because of the control of the directors by Mr. Schwab. In addition thereto, it is evident that the impairment of credit, if any, which Bethlehem complains of, was the result of its own deliberate, unwarranted, and illegal act. Your Receiver submits, therefore, that there was no justification for withholding from the United States Shipbuilding Company the entire earnings of the Bethlehem company, and charges that the inability of the Shipbuilding company to continue its business was due in large part to the failure of the Bethlehem company to relinquish its earnings.

At this point your Receiver desires to call the attention of the Court to another matter somewhat small in comparison with the enormous and unlawful appropriation of stocks and bonds of the United States Shipbuilding Company above mentioned, but of some importance in showing the manner with which the Bethlehem company dealt with the United States Shipbuilding Company. At the time of the sale of the Bethlehem Steel Company to the United States Shipbuilding Company, a statement was made that the amount of inventory was a certain figure. After the sale of the Bethlehem company to the United States Shipbuilding Company, $250,000 of this amount was charged off by the Bethlehem company, for the purpose of adjusting the book value of the inventory with the actual value which had been placed thereon by the accountants after examination. This examination had been made in April, 1902, and the Bethlehem company had been instructed at that time to charge off, to adjustment of inventory, $609,541.95. Instead of complying

with this request, they charged off only $359,541.95, and at the time of the sale of the plant to the United States Shipbuilding Company the statement submitted contained a surplus $250,000 in excess of what Bethlehem knew to be the actual amount.

Still another matter should be brought to the attention of the Court. On the 22d of June, 1903, while proceedings were pending for the appointment of a receiver of the Shipbuilding company, and, as it seems to your Receiver, with a view of forestalling the action of the Court, and in contempt thereof, the directors of said Company adopted a resolution, as provided for under Mr. Schwab's mortgage, requesting the New York Security Trust Company to vote the entire shares of the capital stock of the Bethlehem Steel Company in favor of and for the following persons, as directors of said Bethlehem Steel Company, namely, E. M. McIlvain, Archibald Johnson, Adolphe E. Borie, and Lewis Nixon. Mr. McIlvain was at that time and is now the President of the Bethlehem Steel Company; Mr. Borie was and is the Vice-President of the Bethlehem Steel Company, and Mr. Johnson was and is the General Superintendent of said Company. As the remaining directors were selected by Mr. Schwab's trustee, it is apparent that but one of the seven could be said to represent interests other than those of Mr. Schwab. By this means, if successful, Mr. Schwab was able to place the control of Bethlehem beyond the reach of the Court for at least another year.

Bethlehem Steel Company

From the reports submitted by the officials of this Company, it is evident that during the past year it earned far more money than the necessities of the plant required to be retained there. From what is hereinabove set forth, it is also evident that so long as the present Board of Directors, or a Board subject to present influences, shall retain office, no benefit shall ever be permitted to escape to the Receivership. Your Receiver is convinced that the present controlling influence at this plant is wholly hostile to the Shipbuilding company and its representatives, and your Receiver believes, in view of the excessive price paid for its plant, that the Shipbuilding company, or its repre-

sentative, should be permitted to have at least some voice in its management. At present this is denied, but your Receiver hopes that such action may be taken as may result in the removal of the present Board of Directors, or a majority of them. Your Receiver believes that the meeting of the Board of Directors of the United States Shipbuilding Company, held on the 22d day of June, 1903, and hereinbefore referred to, at which four directors were designated to represent the United States Shipbuilding Company on the Board of the Bethlehem Steel Company, was solely for the purpose of circumventing any order of this Court which might be made in the proceedings then pending; that it was intended to hinder and delay the creditors of the United States Shipbuilding Company and to place this property beyond their control and the control of the Receiver to be appointed, and was otherwise illegal and void. Your Receiver believes such Board is deliberately furthering a course at once illegal and greatly injurious to the creditors represented by your Receiver, and accordingly he makes the recommendation concerning this Company hereinafter set forth.

Generally

Since the appointment of your Receiver the principal office has been engaged in legal matters rather than building ships. Accordingly your Receiver found the services of several of the officers and subordinates of the Shipbuilding company to be unnecessary, and in this connection has reduced expenses upwards of $55,000 a year.

Recommendations

Your Receiver respectfully submits the following recommendations:

1. That in order to avoid depreciation by disuse, and because of the existence of controversies as to the validity of the encumbrances upon the premises, the Crescent Shipyard be sold free and clear of all such encumbrances as soon as the work now in contemplation is completed.

2. That similar action be taken with reference to the plant

of the Harlan & Hollingsworth Company, Wilmington, Delaware.

3. That as soon as the debts of the Company shall have been ascertained suit be instituted against all persons who received the stock of this Company without paying full value therefor to recover from them such an amount as shall be necessary to pay said debts in full, under section 21 of an act of the Legislature of the State of New Jersey, entitled, An Act concerning Corporations (Revision of 1896).

4. That suit be instituted against the Bethlehem Steel Company to procure the appointment of a Receiver and to compel the appropriation of the earnings of that Company by way of dividends on the stock.

Respectfully submitted,

JAMES SMITH, JR.,

Receiver, United States Shipbuilding Company.

Dated October 31, 1903.

Certain other highly disreputable details of this affair, were concerned with the attempts to float the stock in Europe. Much of the correspondence, showing connivance with notorious parties in Paris, was published in the New York daily papers between December 22, 1903, and the first of January, 1904. Moody's Truth about the Trusts, pp. 366–369, gives many additional details. A paper by L. W. Sammis of the *New York Sun*, published in the Annals of the American Academy of Political Science, 1904, is also suggestive. After protracted controversy and litigation, a reorganization plan was agreed upon and published May 25, 1903; and a new company has just been formed to take over the wreck of the old one. — ED.

X

PROMOTERS' LIABILITY FOR UNREVEALED PROFITS[1]—THE ASPHALT COMPANIES

THE visible assets of Asphalt Company of America having been sold and their proceeds distributed, . . . it is proper that the Court should be informed of certain matters and things relating to the promotion of Asphalt Company of America, for such action thereupon as the Court may determine should be taken. The facts hereinafter set forth have been ascertained through investigations made by the Receivers continuing from immediately after their appointment up to the present time.

Asphalt Company of America was incorporated under the laws of the state of New Jersey, June 28, 1899, with an authorized capital stock of $30,000,000, divided into 600,000 shares of the par value of $50 each. The corporation was the outcome of plans previously arranged by and among some or all of the persons hereinafter mentioned as promoters, the essential features of which were (1) the transfer to the corporation of the shares of stock of certain other corporations engaged in the asphalt business and more or less competitive in character, and the issue to the owners of such shares, so transferring their holdings, of Collateral Gold Certificates, in the nature of bond obligations of the new corporation in exchange for said shares of stock, the terms of exchange being mutually arranged, the shares of stock so transferred then being deposited with a trust company (The Land Title and Trust Company being selected) as security for the payment of the interest and principal of the said certificates. (2) The providing of working capital

[1] From Transcript of Record, U. S. Circuit Court of Appeals for the Third Circuit, September Term, 1903. *The Land Title and Trust Co.* v. *Henry Tatnall* as Receiver of Asphalt Co. of America, etc., pp. 370–380. Receiver's Report on Promoters' Liability, etc.

for the new corporation by calls upon its capital stock. In the case of the transfer of the shares of stock by some of the said companies to the new corporation, it was stipulated that, in addition to the purchase price to be paid in Collateral Gold Certificates, the vendors should have the privilege of purchasing stock of Asphalt Company of America, without premium at par, to the amount of 50 per cent of the par value of the stock deposited by them. The following is a list of the corporations whose shares of stock to the amounts and on the terms therein stated were transferred to Asphalt Company, and Collateral Gold Certificates, to the amounts therein mentioned paid therefor:

Name of Company	Total No of Shares	Par Value	Shares Purchased	Price Paid	Cost in Cash	Cost in Certificates
Barber Asphalt Paving Company	39,000	$100.00	38,993	$300.00	———	$11,697,900 00
The New Trinidad Lake Asphalt Company . .	50,000	48.50	49,550	100.00	———	4,955,000.00
			50	84.886	$4244.32	———
Alcatraz Company of West Virginia . . .	800,000	5.00	799,900	6.00	———	4,799,400.00
United Asphalt Company	40,000	100.00	39,975	91.808	———	3,670,000.00
Atlantic Alcatraz Asphalt Company	1,000	100.00	995	1000.00	———	995,000.00
Southern Asphalt Paving Company	250	100.00	245	1020.00	———	249,900.00
Alcatraz Paving Company	1,000	50.00	995	500.00	———	497,500.00
Alcatraz Asphalt Paving Company	1,000	100.00	995	150.00	———	149,250.00
Warren-Scharf Asphalt Paving Company . .	9,500	100.00	9,483	240.00	5618.42	2,278,320.00
Utica Paving Company .	250	100.00	245	510.21	———	125,001.45
Denver Paving Company	35,000	1.00	34,950	5.714	———	199,714.09
Southwestern Alcatraz Asphalt & Construction Company	2,000	100.00	1,995	64.16	———	127,999.20
Alcatraz Construction Company	1,500	100.00	1,495	104.31	———	155,943.45

The evidence in the possession of the Receiver shows that the persons who transferred to Asphalt Company of America the shares of stock in the above named corporations, receiving Col-

lateral Gold Certificates of the former company therefor, had been holders of shares of stock of some of the companies prior to the inauguration of the plan which was subsequently consummated of transferring them to Asphalt Company of America. In the case of some of the companies, however, some of the vendors who were connected with the organization of Asphalt Company of America as promoters, purchased the whole or some part of the shares which they exchanged for Collateral Gold Certificates on the above terms, after they, with others, had determined upon such organization and either while it was in process of organization or after it was actually incorporated. The essential purpose of this report is to show to the Court the facts which have come to the Receiver's knowledge as to those purchases, and to recommend action thereon.

The organization of Asphalt Company of America appears to have been under consideration as early as March 6, 1899, and to have been entered upon very shortly thereafter. At that time the following persons appear to have been holders of record of shares of stock of some of the corporations which were subsequently combined in the manner above stated, to about the following amounts:

	Barber Asphalt Paving Company	The New Trinidad Lake Asphalt Company
	Shares	Shares
Amzi L. Barber held . . .	5507	4394
Francis V. Greene held . .	900	1822
George W. Elkins held . .	1831	1639
J. J. Albright held	2613	3050
Edmund Hayes held . . .	1264	2131
C. K. Robinson held . . .	281	997
E. Burgess Warren held . .	5164	4849
Wm. L. Elkins held . . .	500	—
Geo. D. Widener held . .	1091	1273

	Alcatraz Company of West Virginia	Denver Paving Company
	Shares	Shares
William H. Crocker held .	401,320	1863

	Alcatraz Paving Company	Southwestern Alcatraz & Construction Company
	Shares	Shares
William J Latta held . .	30	—
Harry C Spinks held . .	—	585

Some of the above named parties then acquired shares of stock of other companies subsequently turned into the combination, and they also acquired more shares of stock of some of the companies in which they already had interests. Some of the shares of stock so acquired were then transferred to Asphalt Company of America, when incorporated, at prices payable in Collateral Gold Certificates in excess of the prices at which they were respectively obtained by the purchasers, and the Receiver believes that further investigation will show that all of said shares were transferred by the said purchasers to Asphalt Company of America at a profit. So far as the Receiver knows, no disclosure to Asphalt Company of America was made by the persons who so transferred their shares of stock to it of the profits received by them. All of the above named parties, it is believed, were beneficially interested in the acquisition of some of said shares, and in their transfer to Asphalt Company of America.

The facts in detail for the consideration of the Court follow:

As to United Asphalt Company.

Amzi L. Barber, Francis V. Greene and George W. Elkins each transferred to Asphalt Company of America 13,325 shares of stock of this company, aggregating 39,975 shares. Amzi L. Barber and George W. Elkins each received therefor $1,223,300, and Francis V. Greene received $1,223,400, in Collateral Gold Certificates of Asphalt Company of America, the said three parties receiving as a whole $3,670,000 of said certificates. At the time of said transfers United Asphalt Company was the holder, either in its corporate name, or by its representatives, of practically the entire capital stock of four corporations known as Columbia Construction Company, of New York; Trinidad Bituminous

Asphalt Company, of New Jersey; Standard Asphalt Company, of New Jersey, and Rock Creek Natural Asphalt Company of Kansas. The shares of capital stock of these corporations constituted its entire assets. The evidence in the possession of the Receiver points to the fact that these shares of stock were bought by or under the direction of Amzi L. Barber, Francis V. Greene and George W. Elkins, with money or obligations furnished, or procured, by them to be furnished as follows:

For the stock of Columbia Construction Company . . .	$250,000
" " Trinidad Bituminous Asphalt Company . .	150,000
" " Standard Asphalt Company	200,000
" " Rock Creek Natural Asphalt Company . .	18,000
	$618,000

Said purchases were made between March 21 and August 4, 1899. In the meantime United Asphalt Company had been organized as a holding company, and on July 12, 1899, 13,325 shares of its capital stock were issued to Amzi L. Barber, Francis V. Greene and George W. Elkins each, making 39,975 shares in the aggregate, issued to them out of a total capital stock of 40,000 shares. The above 39,975 shares were subsequently, on July 15, 1899, transferred to Asphalt Company of America for $3,670,000 of its Collateral Gold Certificates. The first sales of the Temporary Certificates standing for said Collateral Gold Certificates were in August, 1899, in the neighborhood of 90 per cent of par. Taking the value of the Collateral Gold Certificates at 97 per cent of par, the highest price at which said certificates sold, the profit each of the said three parties to said transaction was about $980,601, and to all of them together was about $2,941,803. Taking the value of the said certificates at 89½ per cent of par, which was their lowest market price in August, 1899, the profit to each of said parties was about $888,853.50, and to all of them together was about $2,666,560.50.

As to Warren-Scharf Asphalt Paving Company.

Amzi L. Barber, Francis V. Greene and George W. Elkins each transferred to Asphalt Company of America 3164 shares (George W. Elkins transferring 3165 shares) of stock of Warren-Scharf Asphalt Paving Company, aggregating 9493 shares

out of a total capital stock of 9500 shares. They each received therefor $759,360 (George W. Elkins receiving $759,600) in Collateral Gold Certificates. The said three persons received as a whole $2,278,320 par of said certificates.

The said three persons had previously purchased from the then owners the said shares of stock at an outlay to them of about $1,500,000, and the said shares were transferred into their names on July 27, 1899. The transfers of said shares by them to Asphalt Company of America were made on July 31, 1899, and the above mentioned temporary certificates of said company were issued to them therefor. Taking the value of the Collateral Gold Certificates at 97 per cent of par, the profit to each of the said three parties to said transaction was about $236,579, and to all of them together was $709,970. Taking the market value of the certificates at 89½ per cent of par, the profit to each of the said parties was about $179,627.20, and to all of them together about $539,096.

From certain papers in the possession of Receiver it would appear that the moneys necessary to purchase said shares of stock from the preceding holders were contributed by the following parties in the following proportions, and the Receiver believes that distribution of Collateral Gold Certificates was made to said parties in proportion to their contribution to purchase money as follows, and that they shared the profits proportionately:

	Payment of Purchase Money	Distribution of Collateral Gold Certificates
J. J. Albright	$115,875	$176,130
A. L. Barber	233,175	334,426
F. V. Greene	50,550	76,836
Edmund Hayes	64,950	98,724
C. K. Robinson	20,325	30,894
Geo. D. Widener	49,800	75,696
E. B. Warren	215,325	327,294
Geo. W. Elkins	250,000	380,000
Wm. L. Elkins	250,000	380,000
Sydney F. Tyler	250,000	380,000

As to The New Trinidad Lake Asphalt Company, Limited.

Shortly after the organization of Asphalt Company of America was projected, the Board of Directors of Barber Asphalt Company, which company owned 1718 shares of the capital stock of The New Trinidad Lake Asphalt Company, Limited, caused said shares to be offered for sale to its stockholders. This action was taken pursuant to the authorization of its Executive Committee, acting as a Board of Directors, on March 15, 1899, and was approved by the Board on March 29, 1899, the said Board of Directors being composed at the time of the following persons: J. J. Albright, Amzi L. Barber, Francis V. Greene, Edmund Hayes, C. K. Robinson, George D. Widener, George W. Elkins, E. Burgess Warren, and P. W. Henry. 1638 of the said shares of stock of The New Trinidad Lake Asphalt Company, Limited, were thereupon bought by the stockholders of Barber Asphalt Paving Company at the limit fixed by the Executive Committee in its resolution for their sale, to wit, $48.50 per share. 1515 of the said shares so bought were purchased and paid for by the following persons who were also Directors of Barber Asphalt Paving Company at the rate of $48.50 per share, to wit:

J. J. Albright	210	shares
Amzi L. Barber	206	"
Francis V. Greene	178	"
Edmund Hayes	209	"
C. K. Robinson	103	"
George D. Widener	207	"
George W. Elkins	211	"
E. Burgess Warren	211	"

After said purchases of said shares of stock at $48.50 per share, they were transferred to Asphalt Company of America at the valuation of $100 per share and Collateral Gold Certificates were received in exchange therefor to the amount in the aggregate at par of $151.500.

The Receiver believes it can be established that the said parties shared in the profits of said purchases and sales in proportion to their said holdings.

Taking the Collateral Gold Certificates at 97 per cent of par, the profit to said parties from the said purchases and transfers

amounted to $73,477. Taking the value of the Collateral Gold Certificates at 89½ per cent of par, the profit to the said parties amounted to $62,515.

As to Alcatraz Company.

William H. Crocker transferred to Asphalt Company of America on or about August 3, 1899, 799,650 shares of the capital stock of Alcatraz Company of West Virginia. Prior to the formation of the plan of organization of the Asphalt Company of America the said Crocker was the holder of record of 401,320 shares of said company, the balance of the holdings transferred by him to Asphalt Company of America, to wit, 398,330 shares, having been acquired by him after March 8, 1899. The Receiver has not as yet been able to obtain information as to the amount paid by the said Crocker for said 398,330 shares transferred into his name after the organization of Asphalt Company of America was determined upon, nor what profit, if any, was made by him on the purchase or other acquisition by him of said shares and the sale thereof to Asphalt Company of America. The said shares, with the other shares previously held by him ($5 par value), were transferred to Asphalt Company of America at the rate of $6 per share, payable in Collateral Gold Certificates. The actual sum received by him in Collateral Gold Certificates for the shares obtained by him after the plan of organization of Asphalt Company of America was determined upon was at par $2,389,980. The Receiver has reason to believe that a substantial profit was made by the said Crocker in said transaction. He is advised that the relation of the said Crocker to the enterprise was that of a promoter, and that whatever profit was obtained by him he is in law obliged to pay to the Receiver of the Asphalt Company of America.

As to Denver Paving Company.

The said William H. Crocker transferred to Asphalt Company of America 28,725 shares of Denver Paving Company stock at the rate of $5.71 428/1000 per share (the shares being $1 par) and received in exchange therefor at par $164,142.69 in Collateral Gold Certificates. He was the holder of record prior to the

formation of the plan of organization of Asphalt Company of America of only 1863 of said shares. The balance of his holdings transferred to Asphalt Company of America as aforesaid, 26,862 shares, appears to have been acquired by him after the plan of organization of Asphalt Company of America was entered upon. The actual sum received by him in Collateral Gold Certificates for said shares, so as aforesaid subsequently obtained, was at par $153,496.98. The Receiver has reason to believe that a substantial profit was made by the said Crocker in the said transaction. He is advised that the relation of the said Crocker to the enterprise was that of a promoter, and that whatever profit was obtained by him, he is in law obliged to pay to the Receiver of Asphalt Company of America.

As to Alcatraz Paving Company.

William J. Latta transferred to Asphalt Company of America, in July, 1899, 305 shares of Alcatraz Paving Company ($100 par) at the rate of $500 per share, payable in Collateral Gold Certificates of Asphalt Company of America. The actual sum received by him for the said shares, payable in Collateral Gold Certificates at par aforesaid, was $152,500. Prior to the formation of the plan of organization of Asphalt Company of America the said Latta was the holder of record of only 30 of said shares of stock. He appears to have acquired 275 of the shares transferred to Asphalt Company of America as aforesaid after said date. The actual sum received by him in Collateral Gold Certificates for said 275 shares was $137,500. The Receiver has reason to believe that a substantial profit was made by the said Latta in said transaction. He is advised that the relation of the said Latta to the enterprise was that of a promoter and that whatever profit was obtained by him he is in law obliged to pay to the Receiver of Asphalt Company of America.

As to Southwestern Alcatraz Asphalt & Construction Company.

Harry C. Spinks transferred to Asphalt Company of America on or about August 10, 1899, 1995 shares of the stock of the Southwestern Alcatraz Asphalt & Construction Company at the rate of $64.16 per share, payable in Collateral Gold Certificates

of Asphalt Company of America. He received therefor in said certificates at par $127,999.20. The said Spinks actually held of record prior to the entry upon the plan of organization of Asphalt Company of America only 585 of said shares. The evidence in the Receiver's possession indicates that he obtained from various other persons after said date 1410 of said shares which he transferred to Asphalt Company of America upon the total consideration payable in Collateral Gold Certificates at par $90,465.60. The Receiver has not as yet been able to ascertain what profit the said Spinks made out of the purchase of said shares and the transfer thereof to Asphalt Company of America. He is advised, however, that the relations of the said Spinks to the organization of Asphalt Company of America were such that he is obliged to account for and pay over whatever profit he obtained in connection with the said transaction.

From the facts which have come to the knowledge of the Receiver he believes that some or all of the parties above named, to wit, Amzi L. Barber, Francis V. Greene, George W. Elkins, J. J. Albright, Edmund Hayes, C. K. Robinson, E. Burgess Warren, William L. Elkins, George D. Widener, Sydney F. Tyler, William H. Crocker, William J. Latta and Harry C. Spinks, can be established to have been promoters of Asphalt Company of America, and that they made profits in connection with its organization in the manner above stated, which they are obliged to account for, and that they can be compelled to account for and pay over the same. He therefore recommends, the premises considered, that he be authorized by the Court to take such proceedings against the said parties, or any of them, by suit or suits in law or equity, as he may be advised are proper, and as he may deem expedient under the facts as they exist and shall be made to appear upon further investigation, with a view to collecting all profits that were made by the said persons, or any of them, in connection with the organization of Asphalt Company of America and the transfer of securities to it. He also recommends that he be authorized to bring like proceedings against any other persons whom he may hereafter ascertain to have obtained such profits.

He respectfully calls attention of the Court to the fact that

an Act of Limitation was passed by the Legislature of the state of New Jersey at the last session, approved the 8th day of April, 1903, which limits the period during which suits may be brought against directors, officers, promoters and other agents of corporations of the state to recover unlawful profits made by them, to the period of four years from and after the making or receipt of such profits. A saving clause being, however, incorporated in the said Act which permits such suits which otherwise would be barred to be brought within six months after the Act took effect. The result of the passage of the said Act is that proceedings against promoters in connection with Asphalt Company of America with a view to the recovery of unlawful profits obtained by them as the Receiver is advised, must be begun before October 8, 1903. He therefore respectfully urges upon the Court the desirability, if it should seem proper that the Court instruct that any suits of this kind be brought, that the authorization to him to so proceed be given forthwith.

Respectfully submitted,

HENRY TATNALL,
Receiver Asphalt Company of America.

July 6, 1903.

It is scarcely to be expected that a company launched under the conditions described in the foregoing report should have a successful career. Two reorganizations promptly followed in less than four years. The original Asphalt Company of America, organized in July, 1899, acquired the stocks of a large number of competing concerns, issuing in payment therefor $30,000,000 of collateral trust bonds. These bonds were issued on the security of the stock so acquired. The next step was to assure the control of the enterprise by the promoters through ownership of a majority of the capital stock. Accordingly practically all of the original stock subscriptions were taken in the name of two dummies. A large part of this issue of original stock was immediately turned over to the promoters, giving them virtual control of the enterprise. The stock was not paid for in full, but an amount equivalent to 20 per cent of the par value, which was $50 per share, was actually paid. The funds to meet this partial payment on the stock held by the promoters were raised by a sale of the balance of the stock not held by insiders to the public at prices ranging as high as $19 per share. Thus did the promoters acquire control of the holding company without any additional investment on their part; and at the same time possess themselves of a volume of bonds, which, on the basis of the excessive payments described in the preceding

report, proved more than sufficient to absorb the entire earnings of the consolidation.

The existence of a stockholders' liability for the remaining four-fifths of the par value of the capital stock was the cause of the speedy reorganization of the company in May, 1900. By reason of fraudulent and reckless accounting, as partially indicated by our preceding reprint, the inevitable bankruptcy of the parent company was hidden from the public temporarily. In brief, the Asphalt Company of America was superseded in May, 1900, by a new company entitled the National Asphalt Company. This new corporation issued $6,000,000 of Collateral Gold Certificates which were used to take up the stock of the old corporation. In addition, its own capital, amounting to $22,000,000, was used in part to acquire control of formidable competitors who had invaded the field, and in part as a bonus to secure deposit of the old underlying bonds. In December, 1901, this company, in turn, went into the hands of a receiver. Then began a long series of suits and countersuits in connection with the activity of a reorganization committee; which, judged by results, seems to have been working in the interest of insiders. The outcome of the matter was the final organization in May, 1903, of the General Asphalt Company which acquired the properties of its predecessors, sold at auction for a trifle over $6,000,000. This General Asphalt Company was capitalized at $31,000,000, in place of $60,000,000 of stock and bonds issued by the original Asphalt Company of America. The troublesome underlying bonds of the first company were to be retired by exchange for preferred stock; and the common stock was issued in part to raise working capital.

A partial recovery of the enormous losses by innocent investors could be effected only in two ways. Successful suits against the promoters for unrevealed profits in the organization of the company might be hoped for, following precedents in a number of recent cases, notably that of the East Tennessee Land Company. In addition it was possible that the Receiver might be able to hold the original stockholders liable for the balance of their payments on the capital stock of the Asphalt Company of America. This latter should amount to about $24,000,000, while at the same time it was hoped that nearly $3,000,000 could be extorted from the promoters. The first of these remedies against the promoters, however, has now been closed through purchase by the promoters themselves of all the outstanding bonds. As representing all the creditors of the company, they have asked the Court to discontinue the suits. This has been done. Moreover, the Receiver has abandoned the attempt to assess the stockholders for their unpaid capital stock on the ground that such suits cannot be successfully prosecuted. Thus closes a story of fraud and financial rottenness not less enlightening than that of the United States Shipbuilding Company, as showing the necessity for provision by law to secure a reasonable amount of publicity in the finances of monopolistic combinations. — ED.

XI

TRADE COMBINATIONS AT COMMON LAW[1]

THE rule that all contracts in restraint of trade were void, was early established in the English law. The first case in which this principle was announced is said to have been decided in the reign of Henry V.[2] In this case an action for debt was brought on a bond, conditioned that the defendant should not use his art of a dyer's craft within a certain city for six months. Judge Hall declared the bond void, and expressed his indignation at this attempt to restrain trade by exclaiming, "And, by God, if the plaintiff were here, he should go to prison till he paid a fine to the king." This refusal to recognize the validity of any contract in restraint of trade was for a long time characteristic of the English law; but gradually the rule was relaxed.

The modern application of this rule was very well expressed by Judge Christiancy in the case of *Hubbard* v. *Miller*.[3] Dissenting from the doctrine sometimes laid down, that all contracts in restraint of trade are *prima facie* or presumptively void, he said:

> If, considered with reference to the situation, business and objects of the parties, and in the light of all the surrounding circumstances with reference to which the contract was made, the restraint contracted for appears to have been for a just and honest purpose, for the protection of the legitimate interests of the party in whose favor it is imposed, reasonable as between them, and not specially injurious to the public, the restraint will be held valid.[4]

[1] From the *Political Science Quarterly*, Vol. XII, 1897, pp. 212–245. [On decisions interpreting state anti-trust laws to 1900, consult the *Quarterly Journal of Economics*, Vol. XIV, 1900, pp. 416–424. — ED.]

[2] See Year Book, 2 Henry V, fol. 5, pl. 26.

[3] 27 Mich, 15.

[4] This statement was really nothing but an elaboration of the rule which had long before been laid down in the English courts by Chief Justice Tindal, in the case of *Horner* v. *Neves*, 7 Bing., 743.

Under this rule two interests are to be considered, those of the parties to the contract and those of the public. As to the former, the rule was laid down that no contract which did not benefit both parties to the contract should be regarded as reasonable; as to the latter, no contract in restraint of trade was to be regarded as lawful which was injurious to the public. As a matter of fact, most of the cases actually decided have turned exclusively on the interests of the parties, and the tendency of the courts has therefore been to relax very greatly the old rule of the common law. This tendency probably reached its culmination in a case decided in 1887, by the New York Court of Appeals, *Diamond Match Co.* v. *Roeber*.[1] Here the Court was called upon to construe a contract made by Roeber with the Swift, Courtney & Beecher Co., the grantor of the Diamond Match Co., in which he agreed that he would not within ninety-nine years, except in the capacity of agent or employee of the Swift, Courtney & Beecher Match Co., directly or indirectly engage in the manufacture or sale of friction matches in any part of the United States except Nevada and Montana. The Court held the contract to be valid, although practically in general restraint of trade, saying:

> When the restraint is general, but at the same time is coextensive only with the interest to be protected and with the benefit meant to be conferred, there seems to be no good reason why as between the parties the contract is not as reasonable as when the interest is partial and there is a corresponding partial restraint.

But the Court of Appeals, in making this decision, did not intend to depart from the old rule, so far as the maintenance of that old rule was necessary for the protection of the interest of the public. It said distinctly:

> Covenants of the character of the one now in question operate simply to prevent the covenanter from engaging in the business which he sells, so as to protect the purchaser in the enjoyment of what he has purchased. To the extent that the contract prevents the vendor from carrying on the particular trade, it deprives the community of any benefit it might

[1] 106 N. Y., 473.

derive from his entering into competition; but the business is open to all others, and there is little danger that the public will suffer harm from lack of persons to engage in a profitable industry. Such contracts do not create monopolies; they confer no special or exclusive privilege. If contracts in general restraint of trade where the trade is general are void as tending to monopolies, contracts in partial restraint where the trade is local are subject to the same objection, because they deprive the local community of the services of the covenanter in the particular trade or calling, and prevent his becoming a competitor with the covenantee.

And again:

Combinations between producers to limit production and to enhance prices are or may be unlawful, but they stand on a different footing.

This case has frequently been cited, as indicative of a change in the rule of the common law, and as establishing the proposition that in our present economic conditions the policy of the law is, in order to promote the greatest freedom of contract, not to declare void contracts even in total restraint of trade. But the Court of Appeals based its decision upon the express ground that the public interest was not involved. While holding valid the particular contract before it, although in general restraint of trade, the Court specifically declared that combinations to raise prices stood upon a different footing, and recognized the fact that where the public interest was involved, the rule might well be different. The common law has all along refused, and does now refuse, to recognize the validity of agreements made between individuals for the purpose of raising the prices of commodities, and has stamped any such attempt as a criminal conspiracy.

1. Agreements aiming to raise Prices are Invalid

That such agreements are invalid has always been the rule of both courts of equity and courts of law. Thus, take the case of *Craft* v. *McConoughy*.[1] This was a bill in equity brought for an accounting and distribution of the profits of an alleged partnership based upon a contract to the following effect: Several grain houses were put into the business upon a basis of distribut-

[1] 79 Ill., 346, decided in 1875.

ing shares to the signers of the agreement; each separate firm was to conduct its own business as if there were no partnership in existence. It was to be the duty of a general bookkeeper to make a record of all the grain bought by each party, to debit him with the amount of money paid for the same, and to credit him with all sales; and at the end of every month each individual account was to be balanced, showing the profit or loss, which amount was to be divided *pro rata*, according to the number of shares held by each party. It was further agreed that prices were to be fixed from time to time, and each party to the agreement was to abide by them. Soon after the agreement was made, one party to it died, and his son demanded an accounting. The Court held that the agreement was void, as contrary to public policy, and as being an attempt to foster a monopoly and to raise prices; and notwithstanding the fact that it had been partially executed, refused to require an accounting, saying: "The complainant and the defendants were equally involved in the unlawful combination; a court of equity will assist neither."

A similar and even stronger case, decided in Pennsylvania, is that of *Nester* v. *The Continental Brewing Co.*[1] Here an association had been formed in Philadelphia among the brewers, for the purpose of controlling the sale and fixing the price of beer in Philadelphia and in Camden and Camden County, New Jersey. It was shown that the plaintiff had for valuable consideration obtained from a member of the association an assignment of a claim due such member from the association, without knowledge that the claim was based upon an agreement to monopolize the sale of beer. Notwithstanding his *bona fides*, the Court refused to aid him, and denied his application for an accounting.

Not only courts of equity, but also courts of law, refuse to aid in the execution of such agreements. Thus, in the case of *Chapin* v. *Brown*,[2] the grocers engaged in business in the town of Storm Lake agreed in favor of a third person to quit the business of buying butter for two years, and such third person agreed to carry on that business exclusively for the same period

[1] 161 Pa. St., 473, decided in 1894.
[2] 83 Iowa, 156, decided in 1891.

of time. In pursuance of this agreement, the plaintiffs came to the town and engaged in the business of buying butter; at the commencement of the suit they were so engaged, and had made arrangements to continue the business for the period of two years. The defendant, however, continued in the business of buying butter; and it was alleged that by so doing he had damaged the plaintiffs to the extent of one hundred and fifty dollars, for which judgment was asked. The court refused the application of the plaintiffs, on the ground that the agreement was against public policy, as tending to monopolize the butter trade at Storm Lake, and to destroy competition in that business. This case is particularly interesting because the agreement was as to purchase and not as to sale. It therefore did not result in disadvantage to the consuming public generally, but only in disadvantage to the producers of butter.[1]

A somewhat similar case, *More* v. *Bennett*, was decided in January, 1892, by the Supreme Court of Illinois.[2] Here the stenographers in the city of Chicago had formed an association, of which all the parties to the suit were members. The object of the association was to establish and maintain uniform rates. A schedule had been adopted, and it was alleged that the defendant, contrary to the rules of the association, had cut rates against the other members thereof, whereby the plaintiffs had been damaged. The Court refused to pass upon the question whether a contract could be found in such articles of association, and decided that, even if a contract could be found, the agreement was void on account of its attempt to regulate prices. The Court refused, therefore, to award damages to the plaintiff The case is interesting as showing that the courts will apply the same rules to the attempt to regulate the price of labor as to the attempt to regulate the price of commodities.

Another good case is that of the *Texas Standard Oil Co.* v. *Adoue*, decided in Texas in 1892.[3] This suit was brought to recover guaranteed net prices for all the products of certain

[1] It is only fair to say that the contract was declared void, not only because it was contrary to public policy, but also because in the opinion of the Court it was not based upon a consideration.

[2] 140 Ill., 69.

[3] 83 Tex., 650.

mills, and for the costs and expenses of production, in consideration of the strict performance of all convenants in a contract. This contract, it was held by the Court, gave the defendant an almost unrestricted field to obtain the raw material for its mills, and the exclusive right to control, free from the competition of the plaintiffs and others, not only the sales and ruling prices of the product of its own mills, but also the entire yield of the mills of the other parties to the contract. The Court held that the manifest purpose and natural tendency of this agreement were to prevent competition in too many localities — upon the one hand, to reduce the price of the raw materials; and upon the other, to enhance that of the manufactured product by artificial means, to the disadvantage and detriment of the public. Therefore the complaint was dismissed.[1]

A similar case is *Arnott* v. *The Pittston and Elmira Coal Co.*[2] Here the plaintiff's assignor, the Butler Colliery Co., had made an agreement with the defendants that it would not send coal north to any point except to the defendants, the latter agreeing to take from the Butler Co. not exceeding 2000 tons of coal per month. In pursuance of this agreement, the Butler Colliery Co. shipped 2700 tons to The Pittston and Elmira Coal Co., and the plaintiff, to whom it had assigned its claim, brought suit for the price of the coal. The Court held that the contract was made by the defendants with the purpose of establishing a monopoly of coal in the city of Elmira, that this purpose was known to the plaintiff's assignor, the Butler Coal Co., that the contract was contrary to public policy, and therefore that suit might not be brought upon it. The Court said:

Every producer or vendor of coal or other commodity has the right to use all legitimate efforts to obtain the best price for the article in which he deals. But when he endeavors to artificially enhance prices by suppressing or keeping out of market the products of others, and to accomplish that purpose by means of contracts binding them to withhold

[1] This case, like *Chapin* v. *Brown*, noticed above, shows that the courts will take notice that the effect of a combination in restraint of trade is to reduce the prices of articles to be purchased, as well as to increase the price of articles to be sold by the combination.

[2] 68 N. Y., 558, decided in 1877.

their supplies, such arrangements are even more mischievous than combinations not to sell under an agreed price. Combinations of that character have been held to be against public policy and illegal. . . . The purpose of the vendee was against public policy, and the vendor knew it. This brings us straight to the question whether the vendor delivering goods under such a contract can recover for the price. I think that under the circumstances of the present case, as found by the referee, he cannot. . . . He had a right to dispose of his goods, and (under certain limitations) the vendor of goods may recover for their price, notwithstanding that he knows that the vendee intends an improper use of them, so long as he does nothing to aid in such improper use, or in the illegal plan of the purchaser. This doctrine is established by authority, and is sufficiently liberal to vendors. But — and this is a very important distinction — if the vendor does anything beyond making the sale to aid the illegal scheme of the vendee, he renders himself *particeps criminis* and cannot recover for the price.

So, also, it has been held that a loan made for the purpose of aiding in a combination to raise the price of a particular article, cannot be recovered. In the case of *Raymond* v. *Leavitt*,[1] plaintiff had loaned the sum of $10,000 to the defendant for the purpose of controlling the wheat market at Detroit, with a view of forcing up prices. The defendant, who was to give the plaintiff a third of the expected profits, was at all events to repay the $10,000, with or without profits. In rendering its decision, the Court said:

The object of the arrangement between these parties was to force a fictitious and unnatural rise in the wheat market, for the express purpose of getting the advantage of dealers and purchasers whose necessities compelled them to buy, and necessarily to create a similar difficulty as to all persons who had to obtain or use that commodity, which is an article indispensable to every family in the country. . . . We shall decline enforcing such contracts. If parties see fit to invest money in such ventures, they must get it back by some other than legal measures.

Probably the strongest case of all is that of *Morris Run Coal Co.* v. *Barclay Coal Co.*[2] This was an action upon an accepted draft of the defendants in favor of the plaintiffs. The draft was made in execution of a contract between five coal companies

[1] 46 Mich., 447, decided in 1881.
[2] 68 Pa. St., 173, decided in 1871.

for a sum found due in the equalization of prices under the contract. Provision was made in the contract for a committee of three to take charge of the business of all of these companies, to decide all questions and to appoint the general sales-agent. Provision was also made for the mining and delivery of coal, and for its sale through this agent, subject, however, to the restriction that each party should at its own cost deliver its proportion of the different kinds of coal in the different markets, at such times and to such parties as the committee should from time to time direct. The committee was authorized to adjust the price of coal in the different markets, and the rates of freight, and also to enter into such an agreement with the anthracite coal companies as should promote the interest of the parties. The companies were allowed to sell their coal themselves, but only to the extent of their proportion, and only at the prices adjusted by the committee. In answer to the claim that this agreement tended to establish a monopoly, the plaintiff replied that the true object of it was to lessen expenses, to improve the quality of the coal and to deliver it in the market in the best order to the consumer. These allegations the Court said were immaterial:

Admitting their correctness, it does not follow that these advantages redeem the contract from the obnoxious effects so strikingly presented by the referee. The important fact is that these companies control this immense coal-field; that it is the great source of supply of bituminous coal to the state of New York and large territories westward; that by this contract they control the price of coal in this extensive market, and make it bring sums it would not command if left to the natural laws of trade; that it concerns an article of prime necessity for many uses; that its operation is general in this large region, and affects all who use coal as a fuel; and this is accomplished by a combination of all of the companies engaged in this branch of business in the large region where they operate. The combination is wide in scope, general in its influence, and injurious in effects. These being its features, the contract is against public policy, illegal, and therefore void.

Further commenting upon the agreement, the Court said:

The effects produced on the public interest lead to the consideration of another feature of great weight in determining the illegality of

the contract, to wit: the combination resorted to by these five companies. Singly, each might have suspended deliveries and sales of coal to suit its own interests, and might have raised the price, even though this might have been detrimental to the public interest. There is a certain freedom which must be allowed to every one in the management of his own affairs. When competition is left free, individual error or folly will generally find a correction in the conduct of others; but here is a combination of all the companies operating in the Blossburg and Barclay mining regions and controlling their entire productions. . . . This combination has a power in its confederative form which no individual action can confer. The public interest must succumb to it, for it has left no competition free to correct its baleful influence. When the supply of coal is suspended, the demand for it becomes importunate, and prices must rise. Or if the supply goes forward, the price fixed by the confederates must accompany it. . . . Such a combination is more than a contract; it is an offence. . . . The present case is free of difficulty, the money represented by the bill arising directly upon the contract to be paid by one party to another party to the contract in execution of its terms. The bill itself is therefore tainted by the illegality, and no recovery can be had upon it.

While the courts will not enforce an unlawful agreement or give damages for the non-execution of an unlawful agreement, it does not by any means follow that they will prevent the execution of an agreement which is in reasonable restraint of trade. A good case upon this point is that of the *Bohn Manufacturing Co.* v. *Hollis*.[1] The plaintiff was a manufacturer and vendor of lumber and other building material, a large and valuable part of his trade being with retail lumber dealers. The defendant, the Northwestern Lumbermen's Association, was a voluntary association of retail lumber dealers, formed to protect its members against sales by wholesale dealers and manufacturers to contractors and consumers. The method employed by the association was to demand of every wholesale dealer who sold directly to contractors and consumers 10 per cent of the amount of such sales, and to notify all the retail dealers to refrain from dealing with such wholesale dealer until the payment was made. The plaintiff in this suit, having sold

[1] 54 Minn., 223, decided in 1893.

directly to consumers, was requested to pay the 10 per cent to the association, failing which payment the secretary of the association threatened to send to the other retail dealers the notice provided for in the agreement of the association. Plaintiff demanded an injunction to restrain the issuing of these notices. The Court refused the injunction; it held that the agreement was not in unreasonable restraint of trade or unlawful, and recognized that it was a general rule of trade in every department that wholesale dealers should refrain from selling at retail within the territory from which their customers obtain their business.

What one man may lawfully do singly [says the Court], two or more may lawfully agree to do jointly; the number who unite to do the act cannot change its character from lawful to unlawful. The gist of a private action for the wrongful acts of many is not the combination or conspiracy, but the damage done or threatened to the plaintiff by the acts of the defendant. If the act be unlawful, the combination of many to permit it may aggravate the injury, but cannot change the character of the act. In a few cases there may be some loose remarks apparently to the contrary, but they evidently have their origin in a confused and inaccurate idea of the law of criminal conspiracy, and in failing to distinguish between an unlawful act and a criminal one. It can never be a crime to combine to commit a lawful act, but it may be a crime for several to conspire to commit an unlawful act which, if done by one individual alone, although unlawful, would not be criminal. Hence the fact that the defendants associated themselves to do the act complained of is wholly immaterial in this case.

A somewhat similar case is that of *Cote* v. *Murphy*.[1] In this case, workmen engaged in building trades had combined to advance wages by reducing the hours of labor; and associations of employers in such trades had combined and agreed not to sell materials to contractors who acceded to the demands of the workmen, and to induce other dealers by all lawful means not to furnish such materials. The Court held that such associations of employers were not liable in damages for conspiracy to contractors who, by reason of the combination, were not able to procure all the materials they could dispose of.

[1] 159 Pa. St., 420, decided in 1894.

2. Agreements aiming to raise Prices are Criminal

The early English and American cases, regarding labor as in the nature of a commodity, held very frequently that combinations among workingmen for the purpose of raising wages were, even if unaccompanied by any violence or other unlawful acts, criminal conspiracies. One of the earliest cases in this country was that of *People* v. *Fisher*.[1] In this case, certain journeymen shoemakers had combined for the purpose of fixing the wages of members of the combination. They were indicted under a provision of the New York Revised Statutes which declared that if two or more persons should conspire to commit any act injurious to trade or commerce, they should be deemed guilty of a misdemeanor. This provision is regarded as declaratory of the common law. The Court, in its opinion, declared that a combination to raise wages was injurious to trade or commerce, adding:

> It is important to the best interest of society that the price of labor be left to regulate itself, or rather be limited by the demand for it. Combinations and confederacies to enhance or reduce the prices of labor or of any articles of trade or commerce are injurious. They may be oppressive by compelling the public to give more for an article of necessity or of convenience than it is worth, or, on the other hand, by compelling the labor of the mechanic for less than its value.

It is only fair to say that the Court was influenced in its decision by the fact that the indicted shoemakers left the employment of a master workman, in order to force him to discharge one who had formerly been a member of the shoemakers' association, but who had refused to pay the penalty fixed by the association for violation of the agreement not to work for less than a certain sum. It will be seen, therefore, that in this particular case the conspiracy included not only the combination to raise prices, but also something in the nature of a boycott. The Court remarked:

> In the present case an industrious man was driven out of employment by the unlawful measures pursued by the defendants, and an injury done

[1] 14 Wendell, 9, decided in 1835.

to the community by diminishing the quantity of productive labor and of internal trade. . . . He had a right to work for what he pleased. His employer had a right to employ him for such price as they could agree upon. The interference of the defendants was unlawful; its tendency is not only to individual oppression, but to public inconvenience and embarrassment. I am of the opinion that the offence is indictable.

In commenting upon this general subject of labor combinations, the supreme court of Pennsylvania, in the case of *Cote* v. *Murphy*, already referred to, said:

The fixed theory of courts and legislators . . . was that the price of everything ought to be, and in the absence of combinations, necessarily would be, regulated by supply and demand. The first to deny the justice of this theory and to break away from it was labor; and this was soon followed by . . . legislation . . . relieving workmen of the penalties of what for more than a century had been declared unlawful combinations or conspiracies.[1] Wages, it was argued, should be fixed by the fair proportion labor had contributed in production. The market price determined by supply and demand might or might not be fair wages, often was not, and, as long as workmen were not free by combinations to insist upon their right to fair wages, oppression by capital, or which is the same thing, by their employers, followed. It is not our business to pass on the soundness of the theories which prompt the enactment of statutes. One thing, however, is clear: the moment the legislature relieved one and by far the larger number [*sic*] of the citizens of the commonwealth from the common-law prohibitions against combinations to raise the price of labor, and by a combination the price was raised, down went the foundation on which common-law conspiracy was based, as to that particular subject.

The logical consequence of this change in the law was, in the opinion of the Court, that, after employees had combined to raise wages, any combination made by employers against raising wages was not an unlawful conspiracy, inasmuch as the purpose of the employers was, not to interfere with the price of labor as determined by the common-law theory, but to defend themselves against a demand made altogether regardless of the price as regulated by the supply.

[1] Thus, in New York it is provided that it shall not be a criminal conspiracy for persons to combine for the purpose of advancing or maintaining wages. — Laws of 1870, c. 19.

A perusal of the later decisions upon this subject, sometimes made as a result of a change in the ideas of the judges, sometimes made as a result of specific statutes passed upon the subject, must lead to the conclusion that at the present time a combination of laborers for the purpose of raising wages, if unaccompanied by any unlawful act, — as, for example, a boycott or violence, — is not to be regarded as a criminal conspiracy. One of the latest cases upon the subject is *The Longshore Printing Co.* v. *Howell.*[1] In this case the Court held that it was not unlawful for a union to make provision in its by-laws for a scale of wages, or for limiting the number of apprentices; nor was it unlawful for several or many employees to agree among themselves to quit their employer, in order by so doing to induce him to confine his employment to certain kinds of labor.[2]

But while the law at the present time is that combinations of laborers to raise wages, when unaccompanied by any unlawful acts, are not criminal conspiracies, it cannot be said that the old common law generally has been thus changed. That is, notwithstanding the change made in favor of labor, it is still a crime to combine for the purpose of raising the price of commodities. One of the latest cases decided upon this point is *People* v. *Sheldon.*[3] In this case, certain coal dealers in the city of Lockport entered into an agreement to organize a coal exchange. The object of this exchange was to secure a general supervision and protection of the interests of retail dealers in coal and similar commodities. It was made the duty of members strictly to obey all the provisions of the constitution, by-laws and resolutions of the exchange. Any member guilty of violating any provision of the by-laws, or of conduct unbecoming a member, or of giving short weight or overweight, was liable to forfeit his membership. The agreement further declared that the retail price of coal should as far as practicable

[1] 26 Oregon, 527, decided in 1894.

[2] The common law was the same in the case of a combination of employers to reduce wages. Such a combination was a criminal conspiracy. *Com. ex rel. Chew* v. *Carlisle*, Brightley's Report, Pa., 36.

[3] 139 N. Y., 251, decided in 1893.

be kept uniform; and that no price should be made at any time which should exceed a fair and reasonable advance over wholesale rates, or which should be higher than the current price at Rochester or Buffalo, figured upon corresponding freight tariffs; and that at no time should the price of coal at retail exceed by more than one dollar the wholesale cost, except by the unanimous vote of all the members of the exchange. A certain member of the exchange was indicted, on the ground that this agreement constituted an unlawful conspiracy to increase the price of coal at retail in the city of Lockport, and that in pursuance of it the defendant and other members of the exchange elected officers and by resolution increased the price of coal seventy-five cents per ton The indictment was found under section 168 of the Penal Code, which is a reenactment of the provision of the Revised Statutes, making it a misdemeanor for any two or more persons to conspire "to commit an act injurious to the public health, to public morals or to trade or commerce." The trial judge submitted the case to the jury upon the proposition that, if the defendants entered into the organization agreement for the purpose of controlling the price of coal and managing the business of the sale of coal so as to prevent competition in price between the members of the exchange, the agreement was illegal; and that if the jury found that this was their intent, and that the price of coal was raised in pursuance of the agreement to effect this object, the crime of conspiracy was established.

The Court of Appeals, in deciding upon the propriety of this charge, said:

The question here does not, we think, turn on the point whether the agreement between the retail dealers in coal did, as a matter of fact, result in injury to the public, or to the community in Lockport. The question is: Was the agreement, in view of what might have been done under it, and the fact that it was an agreement the effect of which was to prevent competition among the coal dealers, one upon which the law affixes the brand of condemnation? It has hitherto been an accepted maxim in political economy that "competition is the life of trade." The courts have acted upon and adopted this maxim in passing upon the validity of agreements the design of which was to prevent competition

in trade, and have held such agreements to be invalid. . . . The organization was a carefully devised scheme to prevent competition in the price of coal among the retail dealers; and the moral and material power of the combination afforded a reasonable guaranty that others would not engage in the business at Lockport except in conformity with the rules of the exchange. . . . The *gravamen* of the offence of conspiracy is the combination. Agreements to prevent competition in trade are in contemplation of law injurious to trade because they are liable to be injuriously used. . . . If agreements and combinations to prevent competition in prices are or may be hurtful to trade, the only sure remedy is to prohibit all agreements of that character. If the validity of such an agreement was made to depend upon actual proof of public prejudice or injury, it would be very difficult in any case to establish the invalidity, although the moral evidence might be very convincing. We are of opinion that the principle upon which the case was submitted to the jury is sanctioned by the decisions in this state, and that the jury were properly instructed that if the purpose of the agreement was to prevent competition in the price of coal between the retail dealers, it was illegal and justified the conviction of the defendant.

Finally, it has been held that corporations may be guilty of the crime of conspiracy, and that they are so guilty when they refuse to sell their products to dealers handling the products of rival companies.[1]

3. "Trust" Agreements justify Forfeiture of Corporate Charters

The impossibility, under the existing law, of making contracts in restraint of trade which would be enforced by the courts, and the danger that such agreements would be followed by punishment, led to the formation of agreements which took absolutely out of the power of the original owners of a business all control over it.. These agreements, commonly known as trust agreements, provided for trustees who could operate a number

[1] *People* v. *Duke et al.*, *N. Y. Law Journal*, Jan. 23, 1897. It would seem, however, that rebates given on condition that the person receiving the rebate shall deal exclusively with the person giving the rebate are perfectly legal. *Mogul Steamship Co.* v. *McGregor*, H. L. App. Cases, 1892, p. 25; *Nat. Distilling Co.* v. *Cream City Importing Co.*, 86 Wis., 352; *Olmstead* v. *Distilling and Cattle Feeding Co.*, 77 Fed. Rep., 265.

of different enterprises in accordance with their own ideas of what was proper, and who could thus absolutely prevent competition between the parties to the agreements. Such an agreement usually, but not universally, provided for the formation of a corporation out of a partnership wherever a business had been conducted under the latter form. In organizing the trust the stockholders in these corporations exchanged their stock for trust certificates issued by trustees, elected by the persons in interest. The trustees, it was believed, would thus become the only stockholders known to the law, and would therefore have the power of controlling the operations of the corporations whose stockholders had become parties to the trust agreement. In other words, the attempt was made to prevent competition by means of a federation of corporations.

This method was very commonly employed in this country for almost a quarter of a century without being opposed by the public authorities. In 1888, however, attention was directed to a trust agreement in the state of New York, and the attorney-general decided to bring an action in the nature of a *quo warranto* to forfeit the charter of a corporation whose stockholders had participated in its formation. The matter was decided in the case of *People* v. *The North River Sugar Refining Co.*,[1] and this decision was followed by the supreme court of Ohio in *State* v. *Standard Oil Co.*[2] In the New York case the action of the stockholders, even without any formal action upon the part of the corporation, was held to be corporate action, and to be contrary to public policy; the charter of the corporation itself was therefore forfeited. Judge Finch, who delivered the opinion of the Court, said:

I think there may be actual corporate conduct which is not formal corporate action; and where that conduct is directed or produced by the whole body both of officers and stockholders, by every living instrumentality which can possess and wield the corporate franchise, that conduct is of a corporate character, and if illegal and injurious may deserve and receive the penalty of dissolution. . . . The directors of a corporation, its authorized and active agency, may see the stockholders

[1] 121 N. Y., 582, decided in 1890.
[2] 49 Ohio St., 137, decided in 1892.

perverting its normal purposes by handing it over bound and helpless to an irresponsible and foreign authority, and omit all action which they ought to take, offer no resistance, make no protest, but apparently acquiesce as directors in the wrong which as stockholders they have themselves helped to commit. That is corporate conduct, though there may be utter absence of directors' resolutions. . . . The abstract idea of a corporation, the legal entity, the impalpable and intangible creation of human thought, is itself a fiction and has been appropriately described as a figure of speech. It serves very well to designate in our minds the collective action and agency of many individuals as permitted by the law, and the substantial inquiry always is: What, in a given case, has been that collective action and agency? As between the corporation and those with whom it deals, the manner of its exercise usually is material. But as between it and the state the substantial inquiry is only what that collective action and agency has done, and what it has in fact accomplished; what has seemed to be its effective work; what has been its conduct? It ought not to be otherwise. The state gave the franchise, the charter, not to the impalpable, intangible and almost nebulous fiction of our thoughts, but to the corporators, the individuals, the acting and living men, to be used by them, to redound to their benefit, to strengthen their hands and add energy to their capital. If it is taken away, it is taken from them as individuals and corporators, and the legal fiction disappears. The benefit is theirs; the punishment is theirs; and both must attend and depend upon their conduct. And when they all act collectively as an aggregate body without the least exception, and so acting reach results and accomplish purposes clearly corporate in their character, and affecting the vitality, the independence, the utility of the corporation itself, we cannot hesitate to conclude that there has been corporate conduct which the state may review and not be defeated by the assumed innocence of a convenient fiction.

In the Ohio case the reasoning on this head was very similar.[1] In both of these cases, however, the judges felt called upon to consider the further question whether the act which had thus

[1] Judge Marshall said: "The general proposition that a corporation is to be regarded as a legal entity existing separate and apart from the natural persons composing it is not disputed. But that the statement is a mere fiction existing only in idea is well understood and not controverted by any one who pretends to accurate knowledge on the subject. . . . Now, so long as a proper use is made of the fiction that a corporation is an entity apart from its shareholders, it is harmless, and, because convenient, should not be called in question; but where it is urged to an end subversive of its policy, or such is the issue, the fiction must be ignored and the question

taken the form of a corporate act was sufficiently injurious and contrary to public policy to justify the forfeiture of the charter. Here the decisions were somewhat divergent. In New York the Court held that the act of which the corporation had been guilty was in excess of its powers, and that the charter, therefore, was forfeited. The combination of sugar refineries was declared to partake of the nature of a partnership of corporations, and hence to be in violation of law. There was in the opinion a *dictum* as to the injurious effects of monopolies upon the public; but the Court in terms declined

> to advance into the wider discussion over monopolies and competition and restraint of trade, and the problems of political economy. . . . Without either approval or disapproval of the views expressed upon that branch of the case by the courts below, we are enabled to decide that in this state there can be no partnerships of separate and independent corporations, whether directly or indirectly, through the medium of the trust; no substantial consolidations which avoid and disregard the statutory permissions and restraints; but that manufacturing corporations must be and remain several, as they were created, or one under the statute.[1]

In the *dictum* with regard to monopolies, there were several very interesting statements, indicative of the opinion of the Court as to the public policy of permitting combinations whose

determined whether the act in question, though done by shareholders, that is to say, by the persons united in one body, was done simply as individuals and with respect to their individual interests as shareholders, or was done ostensibly as such but, as a matter of fact, to control the corporation and affect the transaction of its business in the same manner as if the act had been clothed with all the formalities of a corporate act. This must be so because, the stockholders having a dual capacity and capable of acting in either, and a possible interest to conceal their character when acting in their corporate capacity, the absence of the formal evidence of the character of the act cannot preclude judicial inquiry on the subject. If it were otherwise, then in one department of the law fraud would enjoy an immunity awarded to it in no other."

[1] The statutes here referred to permitted the consolidation of manufacturing corporations, and the Court in a previous part of the opinion seemed to intimate that a consolidation under the statute would have been perfectly proper, inasmuch as "the resultant combination would itself be a corporation deriving its existence from the state, owing duties and obligations to the state, and subject to the control and supervision of the state, and not [as in the case presented] an unincorporated board, a colossal and gigantic partnership, having no corporate functions and owing no corporate allegiance."

purpose or effect is to promote monopolies. The public interest which corporate grants are always assumed to subserve is most unfavorably affected, said Judge Finch,

> when beyond their own several aggregations of capital they compact them all into one combination which stands outside of the ward of the state, which dominates the range of an entire industry and puts upon the market a capital stock proudly defiant of actual values and capable of an unlimited expansion. It is not a sufficient answer to say that similar results may be lawfully accomplished; that an individual having the necessary wealth might have bought all of these refineries, manned them with his own chosen agents, and managed them as a group at his sovereign will; for it is one thing for the state to respect the rights of ownership and protect them out of regard to the business freedom of the citizen, and quite another thing to add to that possibility a further extension of those consequences by creating artificial persons to aid in producing such aggregations. The individuals are few who hold in possession such enormous wealth, and fewer still who peril it all in a manufacturing enterprise; but if corporations can combine and mass their forces in a solid trust or partnership with little added risk to the capital already embarked, without limit to the magnitude of the aggregation, a tempting and easy road is open to enormous combinations vastly exceeding in number and in strength and in their power over industry any possibilities of individual ownership; and the state, by the creation of the artificial persons constituting the elements of the combination and failing to limit and restrain their powers, becomes itself the responsible creator, the voluntary cause of an aggregation of capital which it simply endures in the individual as the product of his free agency. What it may bear is one thing; what it should cause and create is quite another.

In the Ohio case the Court declared the action of the corporations which formed the trust to be void, as contrary to public policy, on the ground that the attempt was made to form a monopoly. The judge said that the object of the agreement

> was to establish a virtual monopoly of the business of producing petroleum and of manufacturing, refining and dealing in it and all its products throughout the entire country, and by which it might not merely control the production, but the price, at its pleasure. All such associations are contrary to the policy of our state and void. . . .

Much has been said in favor of the object of the Standard Oil Trust and what it has accomplished. It may be true that it has improved the quality and cheapened the cost of petroleum and its products to the consumer. But such is not one of the usual or general results of a monopoly, and it is the policy of the law to regard not what may, but what usually happens. Experience shows that it is not wise to trust human cupidity where it has the opportunity to aggrandize itself at the expense of others. . . . Monopolies have always been regarded as contrary to the spirit and policy of the law. The objections are stated in "The Case on Monopolies," *Darcy* v. *Allein*, Coke, Pt. XI, 84 b. They are these: (1) "That the price of the same commodity will be raised, for he who has the sole selling of any commodity may well make the price as he pleases"; (2) "The Incident to a monopoly is that after the monopoly is granted, the commodity is not so good and merchantable as it was before, for the patentee, having the sole trade, regards only his private benefit and not the commonwealth"; (3) "It tends to the impoverishment of divers artificers and others who before, by the labor of their hands in their art or trade, had maintained themselves and their families, who will now of necessity be constrained to live in idleness and beggary." The third objection, though frequently overlooked, is none the less important. A society in which a few men are the employers and a great body are merely employees or servants is not the most desirable in a republic; and it should be as much the policy of the laws to multiply the numbers engaged in independent pursuits, or in the profits of production, as to cheapen the price to the consumer. Such policy would tend to an equality of fortunes among its citizens, thought to be so desirable in a republic, and lessen the amount of pauperism and crime. It is true that in the case just cited the monopoly had been created by letters patent; but the objections lie not to the manner in which the monopoly is created. The effect on industrial liberty and the price of commodities will be the same, whether created by patent or by an extensive combination among those engaged in similar industries controlled by one management. By the invariable laws of human nature, competition will be excluded and prices controlled in the interest of those connected with the combination or trust.[1]

[1] A similar decision was made by the supreme court of Nebraska in *State* v. *Nebraska Distilling Co.*, 29 Neb., 700, decided in 1890. See also *Mallory* v. *Hananer Oil Works*, 8 S. W. Rep. (Tenn., 1888), where suit was brought against trustees of a trust agreement by a corporation which was a party to such agreement to recover possession of its property. Judgment was given in favor of the plaintiff on the ground that the corporation could not enter into such an agreement, which the Court considered to be a partnership of corporations.

4. Are Corporations for Purposes of Monopoly Illegal?

The effect of the foregoing and similar decisions was that any persons who intended to form a combination for the purpose of limiting competition were obliged to seek a substitute for the trust agreement. As a general thing they effected an organization in the shape of a large corporation, since, as has been shown, the New York Court of Appeals had appeared to regard this as a legal method of forming a combination. The courts were soon required to decide upon the legality of such action. The first case that came up was that of *People* v. *The Chicago Gas Trust Co.*[1] A gas trust company, as it was called, had been formed, in whose certificate of incorporation the purposes of the corporation were stated to be the manufacture of gas and the purchase, holding and selling of stocks in other gas and electric companies in Chicago or elsewhere in Illinois. *Quo warranto* was brought against the corporation to obtain judgment of ouster against its use of the franchise to purchase and hold or sell the capital stock of other companies. It was clearly admitted on both sides that the Court was not precluded from examining into the legality of the exercise of this franchise by the fact that the certificate of incorporation had been approved and filed with the proper executive officers of the state. The general incorporation act of the state permitted the formation of corporations in the manner provided by it for any lawful purpose. The question which arose was, therefore, whether the corporation in question had been formed for a lawful purpose.

In answering this question the Court found that one result of the exercise of this franchise by the Chicago Gas Trust Company would be that it could control the four other companies in Chicago. The control of these four companies, it was thought, would suppress competition among them, and thus build up a virtual monopoly in the manufacture and sale of gas. The Court said:

> Whatever tends to prevent competition between those engaged in a public employment or business impressed with a public character is

[1] 130 Ill, 268, decided in 1889.

opposed to public policy, and therefore unlawful. Whatever tends to create a monopoly is unlawful, as being contrary to public policy.

It therefore held that

if contracts and grants whose tendency is to create monopolies are void at common law, then where a corporation is organized under a general statute, a provision in the declaration of its corporate purposes, the necessary effect of which is the creation of a monopoly, will also be void.

Further on in the opinion it is stated:

To create one corporation for the express purpose of enabling it to control all the corporations engaged in a certain kind of business, and particularly a business of a public character, is not only opposed to the public policy of the state, but is in contravention of the spirit, if not the letter, of the constitution.

The Court also cited with approval the following views expressed by the supreme court of Georgia in the case of *Central Railroad Co.* v. *Collins.*[1]

All experience has shown that large accumulations of property in hands likely to keep it intact for a long period are dangerous to the public weal. Having perpetual succession, any kind of a corporation has peculiar facilities for such accumulations, and most governments have found it necessary to exercise great caution in their grants of corporate powers. Even religious corporations professing, and in the main truly, nothing but the general good, have proven obnoxious to this objection, so that in England it was long ago found necessary to restrict them in their powers of acquiring real estate. Freed as such bodies are from the sure bound to the schemes of individuals, the grave, they are able to add field to field and power to power until they become entirely too strong for that society which is made up of those whose plans are limited by a single life.

For these reasons judgment of ouster was issued against the Chicago Gas Trust Company, as to the exercise of the franchise of purchasing the stocks in other gas companies.

All the cases thus far considered certainly give evidence that the courts of this country regard any combination, whatever form it may take, whose tendency or whose purpose is to form a monopoly, as contrary to public policy and illegal at common

[1] 40 Ga., 582, decided in 1869.

law; but none of them, not even the last, distinctly declares unlawful the formation of a corporation whose purpose or whose effect is to promote monopoly This question it remained for the supreme court of Illinois to consider in the case of the *Distilling & Cattle Feeding Co.* v. *The People.*[1]

In view of the decisions which the courts were almost universally rendering as to the illegality of trust agreements, the holders of trust certificates in the Distillers' & Cattle Feeders' Trust, commonly called The Whiskey Trust, had in February, 1890, adopted a recommendation of the trustees to form a corporation with a capital stock of $35,000,000. The corporation was thereafter organized. The trustees of the former trust subscribed for all the stock of the new corporation and elected themselves its first directors. They, or so many of them as were necessary to constitute a majority of the directors of each of the corporations composing the trust, also ordered a conveyance of all the property which those corporations held, to the newly formed corporation; and as directors of these corporations, they executed to the Distilling & Cattle Feeding Company a transfer of all of the property of these corporations, and surrendered to the holders of the trust certificates the shares of stock in the newly formed corporation in return for the trust certificates. The new corporation subsequently purchased the property and business of other corporations not parties to the former trust agreement. Suit was brought against the new corporation, and judgment of ouster from its franchise was demanded, on the ground that it had created a monopoly in the manufacture and output of distillery products, and secured such control over the consumers thereof as to destroy all competition in the manufacture and sale of such products throughout the United States.

The Court, in rendering its opinion, said:

There can be no doubt, we think, that the Distillers' & Cattle Feeders' Trust, which preceded the incorporation of the defendant, was an organization which contravened well-established principles of public policy, and that it was therefore illegal. [The new corporation succeeded] to the trust, and its operations are to be carried on in the same way, for the same purposes and by the same agencies as before. The trust then

[1] 156 Ill., 448, decided in 1895.

being repugnant to public policy and illegal, it is impossible to see why the same is not true of the corporation which succeeds to it and takes its place. The control exercised over the distillery business of the country — over production and prices — and the virtual monopoly formerly held by the trust are in no degree changed or relaxed, but the method and purposes of the trust are perpetuated and carried out with the same persistence and vigor as before the organization of the corporation. There is no magic in a corporate organization which can purge the trust scheme of its illegality, and it remains as essentially opposed to the principles of sound public policy as when the trust was in existence. It was illegal before and is illegal still, and for the same reasons.

In answer to the objection that the defendant corporation by its charter was authorized to purchase and own distillery property, and that there was no limit placed upon the amount of property which it might thus acquire, the Court said:

It should be remembered that grants of powers in corporate charters are to be construed strictly, and that what is not clearly given is by implication denied. The defendant is authorized to own such property as is necessary to carry on its distillery business, and no more. Its power to acquire and hold property is limited to that purpose, and it has no power by its charter to enter upon a scheme of getting into its hands and under its control all, or substantially all, the distillery plants and the distillery business of the country, for the purpose of controlling production and prices, of crushing out competition, and of establishing a virtual monopoly in that business. All such purposes are foreign to the powers granted by the charter. Acquisitions of property to such extent and for such purpose do not come within the authority to own the property necessary for the purpose of carrying on a general distillery business. In acquiring distillery properties in the manner and for the purposes shown by the information, the defendant has not only misused and abused the powers granted by its charter, but has usurped and exercised powers not conferred by, but which are wholly foreign to, that instrument. It has thus rendered itself liable to prosecution by the state by *quo warranto*. We are of the opinion that upon the facts shown by the information, the judgment of ouster is clearly warranted.

A case involving somewhat similar questions is that of *The People* v. *The Milk Exchange*, decided by the New York Court of Appeals.[1] The Milk Exchange had ninety-odd stockholders,

[1] 145 N. Y., 267, decided in 1895.

a large majority of whom were milk dealers in the city of New York, or creamery or milk-commission men doing business in that vicinity. At the first meeting of the exchange after its incorporation, the following among other by-laws was adopted: "The board of directors shall have the power to make and fix the standard or market price at which milk shall be purchased by the stockholders of this company." Acting upon this by-law, the board of directors from time to time fixed the price of milk to be paid by dealers, and the prices so fixed largely controlled the market in and about the city of New York.

The court, in deciding the case, declared its conviction that there was a combination on the part of milk dealers and creamery men in and about the city of New York to fix and control the price that they should pay for milk; and that a case was presented in which the jury might have found that the combination referred to was inimical to trade and commerce, and therefore unlawful. Accordingly, the charter was declared forfeited.

> It may be claimed [the Court said] that the purpose of the combination was to reduce the price of milk and, it being an article of food, such reduction was not against public policy. But the price was fixed for the benefit of the dealers, and not the consumers, and the logical effect upon the trade of so fixing the price by the combination was to paralyze the production and limit the supply, and thus leave the dealers in a position to control the market, and at their option to enhance the price to be paid by the consumers.

This case is interesting as showing that the courts will take cognizance of an attempt through a combination in the form of a corporation to lower the price of commodities to the detriment of the producer as well as of an attempt to enhance the price at the expense of the consumer.

5. Attitude of the United States Supreme Court

Notwithstanding the decisions thus far considered, persons who desired to form a trade combination were able to do so with impunity, on account of the fact that if their organization was declared illegal in one state, they could organize under the

laws of another, provided the public opinion in the latter was not opposed to trade combinations. An attempt was therefore made in what is known as the Anti-Trust Law, passed by Congress in 1890, to give the national government the power, in addition to that which the states already possessed, to suppress trade combinations. But it was recognized by the promoters of this bill that Congress had no jurisdiction of specifically state industry and commerce. The act was, therefore, worded as follows: "Every contract, combination in the form of trust or otherwise, or conspiracy in restraint of trade or commerce among the several states or with foreign nations is hereby declared to be illegal." Every one participating in such a contract or engaging in such a combination was declared to be guilty of a misdemeanor, and made liable to severe punishment. It was provided that the circuit courts of the United States should have jurisdiction to restrain violations of the act, and that it should be the duty of the law officers of the United States to institute the proper proceedings. A suit was begun in Pennsylvania against certain sugar-refining corporations which had been absorbed by the American Sugar Refining Company. Evidence was taken before Judge Butler, of the Circuit Court, who said in his opinion: "The object in purchasing the Philadelphia refineries was to obtain a greater influence or more perfect control over the business of refining and selling sugar in this country." The opinion also showed that, after the purchase of these refineries by the American Sugar Refining Company, the latter corporation had obtained control of all refineries in the United States except one in Boston, whose output was about two per cent of the sugar refined in this country.

This case went on appeal to the Supreme Court of the United States.[1] Here, on the state of facts presented by Judge Butler, the Court held that the act of 1890 was framed in the light of well-settled principles; that

Congress did not attempt thereby to assert the power to deal with monopoly directly as such, or to limit and restrict the rights of corporations created by the states or the citizens of the states in the acquisition,

[1] *United States* v. *E. C. Knight Co.*, 156 U. S., 1.

control or disposition of property, or to regulate or prescribe the price or prices at which such property or the products thereof should be sold, or to make criminal the acts of persons in the acquisition and control of property which the states of their residence or creation sanctioned or permitted. . . . The contracts and acts of the defendants related exclusively to the acquisition of the Philadelphia refineries and the business of sugar-refining in Pennsylvania, and bore no direct relation to commerce between the states or with foreign nations. . . . . It is true that the bill alleged that the products of these refineries were sold and distributed among the several states, and that all the companies were engaged in trade or commerce with the several states and with foreign nations. But this was no more than to say that trade and commerce served manufacture to fulfil its functions. . . . It does not follow that an attempt to monopolize or the actual monopoly of the manufacture was an attempt, whether executory or consummated, to monopolize commerce, even though in order to dispose of the product the instrumentality of commerce was necessarily invoked. . . . There was nothing in the proofs to indicate any intention to put a restraint upon trade or commerce; and the fact, as we have seen, that trade or commerce might be indirectly affected was not enough to entitle the claimants to a decree. The subject-matter of the sale was shares of manufacturing stock, and the relief sought was the surrender of property which had already passed and the suppression of the alleged monopoly in manufacture by the restoration of the *status quo* before the transfers; yet the act of Congress only authorized the circuit courts to proceed by way of preventing and restraining violations of the act in respect of contracts, combinations or conspiracies in restraint of interstate or international trade or commerce.

It will be noticed that this decision was based upon three grounds: (1) that the proper remedy was not invoked, or at any rate was not invoked at the proper time; (2) that the combination did not disclose an attempt to monopolize; (3) that, even if it did so, it was not a combination in restraint of interstate or foreign commerce.

As to the first of these grounds, it may be said that the bill which was before the court asked that an injunction might issue to prevent and restrain the said defendants from further and continued violations of the act of Congress. This was in addition to the demand that the agreements between the defendants be cancelled and that the shares of stock transferred in perform-

ance of the contracts be restored to their original owners.[1] As to the second ground of the decision, the trial judge found, as has been stated, that the object in purchasing the Philadelphia refineries was to obtain a greater influence or more perfect control over the business of refining and selling sugar in this country. Moreover, the state courts, in the decisions heretofore cited, have declared that they will go back of any alleged purpose of an agreement or of a certificate of incorporation and will inquire what is its real purpose and effect; and that if the latter are to establish a monopoly unreasonably limiting competition, they will declare the agreement void.

But while these first two considerations undoubtedly influenced the Supreme Court somewhat, the main ground upon which the decision was based was that the manufacture and sale of sugar were not interstate or foreign commerce. In order to reach this decision, the Court laid little stress upon the purpose to monopolize the sale. The sale of sugar was declared to be merely an incident to the manufacture. As the Court said, "trade and commerce serve manufacture to fulfil its functions." Laying the weight which they did upon the manufacture, they considered that they were bound by the case of *Kidd* v. *Pearson.*[2] Here the

question was discussed whether the right of a state to enact a statute prohibiting within its limits the manufacture of intoxicating liquors, except for certain purposes, could be overthrown by the fact that the manufacturer intended to export the liquors when made; and it was held that the intent of the manufacturer did not determine the time when the article or product passed from the control of the state and belonged to commerce, and that therefore the prohibitory act was not in conflict with the constitutional provision giving the right to regulate interstate commerce to Congress.

[1] Judge Harlan, in his dissenting opinion, said on this point: "While a decree annulling the contracts under which the combination in question was formed may not in view of the facts disclosed be effectual to accomplish the object of the act of 1890, I perceive no difficulty in the way of the court passing a decree declaring that that combination imposes an unlawful restraint upon trade and commerce among the states and perpetually enjoining it from further prosecuting any business pursuant to the unlawful agreements under which it was formed or by which it was created."

[2] 128 U. S., 1.

Another case which seems to have influenced the Court was that of *Coe* v. *Erroll*.[1] Here the question was "whether certain logs cut at a place in New Hampshire and hauled to a river town for the purpose of transportation to the state of Maine were liable to be taxed like other property in the state of New Hampshire"; and it was held that they were liable to taxation just as much as any other property in the state, and that the owner's intention and his partial preparation to ship them out of the state would not exempt them from taxation as articles of interstate commerce.

Judge Harlan, in a dissenting opinion, pointed out, however, that, under previous decisions of the Supreme Court, interstate commerce embraced something more than the mere physical transportation of articles of property and the vehicles or vessels by which such transportation was effected. He referred in particular to the case of *Mobile County* v. *Kimball*,[2] where it was said that commerce with foreign countries and among the states, strictly considered, consists "in intercourse and traffic, including in these terms navigation and transportation and transit of persons or property, as well as the *purchase, sale and exchange* of commodities." Judge Harlan did not consider that these early statements and decisions had been modified by either of the cases referred to in the majority's opinion. As regards the question of monopoly, he said:

> A combination such as that organized under the name of the American Sugar Refining Company has been uniformly held by the courts of the states to be against public policy and illegal because of its necessary tendency to impose improper restraints upon trade.

And further:

> The object of this combination was to obtain control of the business of making and selling refined sugar throughout the entire country. Those interested in its operations will be satisfied with nothing less than to have the whole population of America pay tribute to them. That object is disclosed upon the very face of the transactions described in the bill, and it is proved — indeed conceded — that that object has been accomplished to the extent that the American Sugar Refining

[1] 116 U. S., 517. [2] 102 U. S., 691.

Company now controls 98 per cent of all the sugar-refining business in the country, and therefore controls the price of that article everywhere. Now the mere existence of a combination having such an object and possessing such extraordinary power is itself under settled principles of law — there being no adjudged case to the contrary in this country — a direct restraint of trade in the article for the control of the sales of which in this country that combination was organized. And that restraint is felt in all the states for the reason known to all, that the article in question goes, was intended to go and must always go into commerce among the several states and into the homes of people in every condition of life.

Finally, Judge Harlan argued for the public policy of the Anti-Trust Law in the following language:

> We have before us the case of a combination which absolutely controls, or may at its discretion control, the price of all refined sugar in this country. Suppose another combination organized for private gain and to control prices should obtain possession of all the large flour mills in the United States; another of all the grain elevators; another of all the oil territory; another of all the salt-producing regions; another of all the cotton-mills; and another of all the great establishments for slaughtering animals and the preparation of meats. What power is competent to protect the people of the United States against such dangers except a national power — one that is capable of exerting its sovereign authority throughout every part of the territory and over all the people of the nation?

The decision of the United States Supreme Court, holding that the manufacture and sale of commodities were not, as not being objects of interstate commerce, subject to the regulation of Congress, was therefore not reached without protest; but the Court was so nearly unanimous in its decision as to justify the belief that the decision itself will not be reversed in the immediate future.[1] The experiences of the states and the arguments advanced by Judge Harlan in his dissenting opinion would lead also to the belief that the regulation of these trade combinations by the states is practically impossible. Any attempt at efficient regulation must come from the national government.

[1] The opinion of the majority in the recent case of the Trans-Missouri Freight Association seems, however, to render the future tendency somewhat uncertain.

In view of the fact that great insistence was laid in the last presidential campaign upon the necessity of some efficient regulation of combinations in restraint of trade, it may be well to summarize the views that the courts have expressed as to the impolicy of permitting these combinations to exist and of recognizing or enforcing in any way contracts for executing their purposes.

The reasons given by the courts for their attitude may be classified under three heads, — economic, social and political. The economic reasons are two in number. In the first place, it is believed by the courts that a combination in restraint of trade and tending to promote a monopoly will result either in the sale of a depreciated article to the public, or in an enhancement of the price of the article which is so controlled. This was the important economic reason at the basis of the decision in the time of Queen Elizabeth, relative to monopolies granted by the crown. This reason has had so much weight with the courts that they have refused to investigate the question whether such has been the effect of a combination. They have simply declared that the possession of monopoly powers by any combination must inevitably result in an enhancement of price or in a depreciation in the quality of the article sold. Their reasoning here, it will be noticed, is distinctly *a priori;* and so long as they adhere to this principle, it will be impossible to prove by reference to actual facts whether it is based upon the truth or not. The second economic argument advanced by the courts in support of their policy is that the fixing by any combination of the price of raw materials injures the producer of the raw material, and will ultimately result in disadvantage to the consumer.

The social argument against combinations also dates from the time of Elizabeth. A monopoly, the Court said,

> tends to the impoverishment of divers artificers and others who before by the labor of their hands in their art or trade have maintained themselves and their families, who will now of necessity be constrained to live in idleness and beggary.

In the form in which it is put, this argument would seem to rest

on a misapprehension of the conditions caused by monopolies; and if applied in as broad a way as it is stated in this case, it would be available against the introduction of all labor-saving machinery. In the Ohio case of *The State* v *The Standard Oil Co.*, already referred to, this argument was somewhat modified. The Court took the ground, not so much that the formation of the combination throws great numbers of individuals out of employment, as that the development of monopolies transforms great numbers of persons formerly independent into employees or servants. This argument, though treated by the Ohio court as a development of the view of the English court in the case of monopolies, is really quite different in character. A further argument of a social character is to be found in the opinion of Judge Finch in the Sugar Trust case. He based the right of the state to limit the activity of corporations, as distinct from that of individuals, on the ground that a direct grant of corporate powers would, if these powers were not limited, aid in the aggregation of wealth in a few hands. He did not desire to limit the right of individual action, but merely claimed that when specific powers which can only exist as a result of the grant of the state are exercised by individuals, they become rightly subject to regulation in the interest of the state as a whole. It is one thing, said he, for the state to respect the rights of ownership and protect them out of regard to the business freedom of the citizen; but it is quite another thing for the state positively to promote the aggregation of capital by creating artificial persons such as corporations, without limiting their powers.

The political reason advanced by the courts for their position with regard to trade combinations is perhaps as well stated as anywhere by the supreme court of Georgia. Here it is pointed out that all large accumulations of property in hands likely to keep it intact for a long period are dangerous to the public weal. In England it was found necessary to limit the amount of property which even religious corporations might possess, notwithstanding the fact that they, far more than trading bodies, might be expected to exercise their powers for the general good. Given the privilege of legal immortality, corporations, it was held, are apt to "become entirely too strong for that society

which is made up of those whose plans are limited by a single life."

Such are the rules of law in the United States with regard to the legality of trade combinations, and such are the reasons which the courts have advanced for the adoption of these rules. If these reasons are not sound, if the conditions of society are not what they were when these rules were adopted and these reasons were first advanced, it would be well that the rules of law be changed. Changes may be made by legislation, as has very generally been done in the case of labor combinations. If, on the other hand, these reasons are now sound and the rules of law based thereon are at the present time in accordance with public policy, some method ought to be provided for their efficient enforcement. This, it has been pointed out, can in the cases of the largest combinations now in existence be done only through the modification of the present rule of the United States Supreme Court with regard to national regulation of monopolies; or, in case the Supreme Court shall not see fit to modify its rules, by the adoption of a constitutional provision giving the Congress of the United States the necessary powers.

FRANK J. GOODNOW.

XII

INTERPRETATION AND AMENDMENT OF THE SHERMAN ANTI-TRUST ACT[1]

I HAVE the honor to submit, in response to your request, the following statements under the three heads which you have indicated, namely: The questions which have been decided by the courts, the questions which are pending in the courts, and suggestions respecting further legislation.

I. QUESTIONS WHICH HAVE BEEN DECIDED BY THE COURTS

The act of July 2, 1890, entitled "An act to protect trade and commerce against unlawful restraints and monopolies," has been before the Supreme Court of the United States in the following cases:

United States v. *E. C. Knight Co.*, 156 U. S., 1;

United States v. *Trans-Missouri Freight Association*, 166 U. S., 290;

United States v. *Joint Traffic Association*, 171 U. S., 505;

United States v. *Hopkins*, 171 U. S., 578;

Anderson v. *United States*, 171 U. S, 604; and

Addyston Pipe and Steel Co. v. *United States*, 175 U. S., 211.

In the Knight case there was involved an alleged monopoly in the production of sugar, commonly known as the "sugar trust"; in the Freight Association, and Joint Traffic Association cases, agreements among interstate railways to fix and maintain rates and fares; in the Hopkins and Anderson cases, two live

[1] Reply of the Attorney-General to a communication from the Hon. George F. Hoar, Chairman of the Committee on the Judiciary of the United States Senate, Jan. 3, 1903.

stock exchanges located in Kansas City, and in the Addyston Pipe and Steel Company case, a combination among competing shops located in different states, and engaged in making cast-iron pipe for gas, water, and sewer purposes, to control prices by suppressing competition among themselves.

In the Knight case the Court held that the creation of a monopoly in production does not necessarily and directly restrain commerce among the states. The Court drew the line between production and interstate commerce, the former being subject to the regulation of the states, the latter alone to that of Congress.

In the Freight Association case the Court held that the Anti-Trust Law applies to railroads, and that it prohibits *all* agreements in restraint of interstate commerce, whether the restraint be reasonable or unreasonable.

This was followed by the Joint Traffic decision, the Court holding in addition that the Anti-Trust Law is valid and constitutional, and that Congress has the power to say that a contract shall not be lawful which restrains trade or commerce among the several states by stifling competition.

In the Hopkins case, it was held that the business of the members of the Kansas City Live Stock Exchange was not interstate commerce within the meaning of the Anti-Trust Law, and therefore the agreement creating that exchange did not operate to restrain trade or commerce among the several states.

In the Anderson case the Court took the view that whether the members of the Traders' Live Stock Exchange of Kansas City were or were not engaged in interstate commerce, the agreement creating the exchange was not one in restraint of such trade.

In the Addyston Pipe Company case the Court held that Congress may prohibit the performance of any contract between individuals or corporations where the natural and direct effect is to regulate or restrain interstate commerce, and that a combination among formerly competing shops, which directly restrained not simply the manufacture, but the sale of a commodity among the several states, comes within the Anti-Trust Law.

Stated in more detail the cases are as follows:

UNITED STATES *v.* E. C. KNIGHT COMPANY (Sugar Trust)

(60 Fed. Rep., 306; Pennsylvania.)
(60 Fed. Rep., 934; circuit court of appeals, third circuit.)
(156 U. S., 1; U. S. Supreme Court, March 26, 1894; Opin., Fuller, Ch. J. Harlan, J., dissenting.)

A bill in equity to enjoin the operation of the so-called "sugar trust." The bill was dismissed by the circuit court, its decree affirmed by the circuit court of appeals, and its judgment affirmed by the Supreme Court of the United States.

It appeared in this case that, by the purchase of the stock of four Philadelphia refineries, through the exchange of shares of its own stock, the American Sugar Refining Company acquired nearly a complete control of the manufacture of refined sugar in the United States. The Government charged that the contracts under which these purchases were made constituted combinations in restraint of trade or commerce in refined sugar among the several states and with foreign nations and asked the cancellation of the contracts and the redelivery of the stock.

The Government's contention was that the purpose of the purchase was to acquire a substantial monopoly of sugar refining, and as the product was a necessary of life, manufactured for sale and distribution among the several states and in foreign countries, that the effect of the arrangement was to restrain and monopolize interstate and foreign commerce.

But the Supreme Court held that, conceding a monopoly was created, it was a monopoly in the production of sugar and not in its sale or distribution among the several states. If a monopoly in interstate commerce followed a monopoly in production, it was but indirect and incidental and not within the prohibition of the Anti-Trust Law. It was for the states to regulate production; the authority of Congress was limited to commerce among the states.

Doubtless, said the Chief Justice (page 12), the power to control the manufacture of a given thing involves in a certain sense the control of its disposition, but this is a secondary and not the primary sense; and although the exercise of that power may result in bringing the operation

of commerce into play, it does not control it, and affects it only incidentally and indirectly. Commerce succeeds to manufacture, and is not a part of it.

Again, page 16:

Contracts, combinations, or conspiracies to control domestic enterprise in manufacture, agriculture, mining, production in all its forms, or to raise or lower prices or wages, might unquestionably tend to restrain external as well as domestic trade, but the restraint would be an indirect result, however inevitable and whatever its extent, and such result would not necessarily determine the object of the contract, combination, or conspiracy.

* * * * * * * *

It was in the light of well-settled principles that the act of July 2, 1890, was framed. Congress did not attempt thereby to assert the power to deal with monopoly directly as such; or to limit and restrict the rights of corporations created by the states or the citizens of the states in the acquisition, control, or disposition of property; or to regulate or prescribe the price or prices at which such property or the products thereof shall be sold; or to make criminal the acts of persons in the acquisition and control of property which the states of their residence or creation sanctioned or permitted. Aside from the provisions applicable where Congress might exercise municipal power, what the law struck at was combinations, contracts, and conspiracies to monopolize trade and commerce among the several states or with foreign nations; but the contracts and acts of the defendants related exclusively to the acquisition of the Philadelphia refineries and the business of sugar refining in Pennsylvania, and bore no direct relation to commerce between the states or with foreign nations.

United States *v.* Trans-Missouri Freight Association

(53 Fed. Rep., 440 Kansas.)
(58 Fed. Rep., 58; circuit court of appeals, eighth circuit.)
(166 U. S., 290; Supreme Court, March 22, 1897; Opin., Peckham, J.)

The contract or combination assailed in this case was an agreement among a large number of interstate railways, creating an association and providing a method of fixing rates and fares on competitive interstate freight traffic south and west of the

Missouri River. The agreement expressly declared that the association was formed, among other things, "for the purpose of mutual protection, by establishing and maintaining *reasonable* rates," etc.

The questions vigorously discussed in the case were whether the Anti-Trust Law applies to railroads, and whether it declares illegal all contracts in restraint of trade, whether reasonable or unreasonable.

The Court held that the law does apply to railroads and that it prohibits all contracts in restraint of trade or commerce among the several states and with foreign nations, whether the restraint be reasonable or unreasonable.

Four of the justices — White, Field, Gray, and Shiras — dissented in an opinion delivered by Mr. Justice White, upon the ground that the restraint of trade condemned by the statute is an unreasonable restraint, such as was unlawful at common law.

United States *v.* Joint Traffic Association

(76 Fed. Rep., 895; New York.)

(89 Fed. Rep., 1020; circuit court of appeals, second circuit.)

(171 U. S., 505; Supreme Court, October 24, 1898; Opin., Peckham, J.)

The Joint Traffic case grew out of an agreement, similar to that in the Trans-Missouri, creating an association to fix rates and fares on competitive interstate traffic east of Chicago. Nine trunk line systems — the Baltimore and Ohio, the Chesapeake and Ohio, the Erie, the Grand Trunk, the Lackawanna, the Lehigh, the Pennsylvania, the Vanderbilt, and the Wabash, — practically controlling the business of railroad transportation between Chicago and the Atlantic seaboard, were covered by the arrangement.

The agreement expressly declared that it was entered into only to establish and maintain "reasonable and just rates, fares," etc., and stated that the powers conferred upon the managers should be so construed and exercised as not to permit the violation of the interstate commerce act or any other applicable law.

In addition to the points discussed in the Trans-Missouri case,

which counsel for the railroads attempted to re-argue, it was insisted that the Anti-Trust Law is unconstitutional.

The Court followed its decision in the Trans-Missouri case, holding that there was no substantial difference between the Trans-Missouri and the Joint Traffic agreements, and, upon the constitutional question, held that Congress has the power, in regulating interstate commerce carried on by railroad corporations, to say that no contract or combination shall be legal which restrains such trade or commerce by shutting out the operation of the general law of competition.

In this case, as in the Trans-Missouri, the Court considered it no defence that the rates established or to be established were reasonable. The fact that the creation of the association prevented any real competition between the railway systems involved was held to restrain the trade or commerce carried on by them.

The natural, direct, and immediate effect of competition, said the Court (page 577), is, however, to lower rates, and to thereby increase the demand for commodities, the supplying of which increases commerce, and an agreement, whose first and direct effect is to prevent this play of competition, restrains instead of promoting trade and commerce.

Hopkins *v.* United States

(82 Fed. Rep., 529; Kansas.)

(84 Fed. Rep., 1018; circuit court of appeals, eighth circuit.)

(171 U. S., 578; Supreme Court, October 24, 1898; Opin., Peckham, J.)

This was a bill in equity, filed by direction of the Attorney-General, against Hopkins and other members of the Kansas City Live Stock Exchange, to secure a dissolution of the exchange on the ground that its members were in a combination in restraint of commerce among the several states.

It seems that this exchange was an association of men doing business at the stock yards in Kansas City, part of these yards being in Missouri and part in Kansas. The business of the members was to receive live stock shipped from other states, care for and sell the same, and account to the owners for the proceeds after deducting charges and expenses. Under the

rules, members were prohibited from buying live stock from commission merchants in Kansas City not members of the exchange. The rules also fixed a commission, prohibited the employment of agents to solicit consignments except upon stipulated salary, and forbade the sending of prepaid telegrams or telephone messages with information as to the condition of the markets.

The Court held that the business conducted by the members of the exchange was not interstate, but local in character, and therefore decided the case against the government.

Page 588:

The sale or purchase of live stock as commission merchants at Kansas City is the business done, and its character is not altered because the larger proportion of the purchases and sales may be of live stock sent into the state from other states or from the territories. Where the stock came from or where it may ultimately go after a sale or purchase, procured through the services of one of the defendants at the Kansas City stock yards, is not the substantial factor in the case. The character of the business of defendants must, in this case, be determined by the facts occurring at that city.

If an owner of cattle in Nebraska accompanied them to Kansas City and there personally employed one of these defendants to sell the cattle at the stock yards for him on commission, could it be properly said that such defendant, in conducting the sale for his principal, was engaged in interstate commerce? Or that an agreement between himself and others not to render such services for less than a certain sum was a contract in restraint of interstate trade or commerce? We think not. On the contrary, we regard the services as collateral to such commerce and in the nature of a local aid or facility provided for the cattle owner toward the accomplishment of his purpose to sell them, and an agreement among those who render the services relating to the terms upon which they will render them is not a contract in restraint of interstate trade or commerce.

Page 590:

The selling of an article at its destination, which has been sent from another state, while it may be regarded as an interstate sale and one which the importer was entitled to make, yet the services of the individual employed at the place where the article is sold are not so connected with the subject sold as to make them a portion of interstate commerce,

and a combination in regard to the amount to be charged for such service is not, therefore, a combination in restraint of that trade or commerce. Granting that the cattle themselves, because coming from another state, are articles of interstate commerce, yet it does not therefore follow that before their sale all persons performing services in any way connected with them are themselves engaged in that commerce, or that their agreements among each other relative to the compensation to be charged for their services are void as agreements made in restraint of interstate trade.

Page 592:

The contract condemned by the statute is one whose direct and immediate effect is a restraint upon that kind of trade or commerce which is interstate. Charges for such facilities as we have already mentioned are not a restraint upon that trade, although the total cost of marketing a subject thereof may be thereby increased. Charges for facilities furnished have been held not a regulation of commerce, even when made for services rendered or as compensation for benefits conferred.

ANDERSON *v.* UNITED STATES

(82 Fed. Rep., 998; Kansas; circuit court of appeals, eighth circuit.)

(171 U. S., 604; Supreme Court, October 24, 1898; Opin., Peckham, J.)

This case was somewhat similar to the Hopkins case, being a bill in equity filed by direction of the Attorney-General against the members of the Traders' Live Stock Exchange of Kansas City to compel its dissolution. The main difference between this exchange and that involved in the Hopkins case was that while the members of the Traders' Exchange were purchasers of live stock on the market, the members of the Live Stock Exchange were only commission merchants who sold the live stock upon commission as a compensation for their services.

The rules of the exchange relied upon by the government as restraining interstate commerce were those which forbade the recognition of any yard trader unless he was a member of the exchange, which required all the members of a partnership to

be members of the exchange, which provided that no member of the exchange should employ any person to buy or sell cattle unless such person was a member of the exchange, and which prohibited the payment of any fee to any buyer or salesman for buying cattle from or selling cattle to such party.

Without passing upon the question whether the members of this exchange were or were not engaged in interstate commerce, the Court held that the rules objected to were of a character to enforce the purpose and object of the exchange, and viewed in that light were reasonable and fair. They could affect interstate trade or commerce in but a remote way, and therefore could not be regarded as in restraint of such trade or commerce.

The Court (page 615) restated the rule that where the subject-matter of the agreement does not directly relate to and act upon and embrace interstate commerce, and where the undisputed facts clearly show that the purpose of the agreement was not to regulate, obstruct, or restrain that commerce, but that it was entered into with the object of properly and fairly regulating the transaction of the business in which the parties to the agreement were engaged, such agreement would be upheld as not within the statute.

Addyston Pipe and Steel Company *v.* United States [1]

(78 Fed. Rep., 712; Tennessee.)
(85 Fed. Rep., 271; circuit court of appeals, sixth circuit.)
(175 U. S., 211; Supreme Court, December 4, 1899; Opin., Peckham, J.)

This case grew out of a combination of six shops, located, one in Ohio, one in Kentucky, two in Tennessee, and two in Alabama, which were engaged in making cast-iron pipe for gas, water, and sewer purposes. These shops controlled the market in that commodity in thirty-six states west of the Alleghany mountains and south of Virginia. They entered into an agreement to control prices by suppressing competition among themselves. This was done by appointing a representative board of

[1] See Chapter V, p. 86, *supra* for fuller details.

one from each shop, to which all inquiries for pipe were referred. The board fixed the price it thought the job would stand. The job was then sold over the table, the shop which bid the highest bonus for the benefit of the pool getting it. At the public letting, the shop that got the job bid the fixed price, and the other shops overbid in order to deceive the public.

On behalf of the combination it was contended that the power of Congress, under the interstate-commerce clause, does not extend to agreements among private corporations, but is limited to acts of interference by the states and by quasi-public corporations, such as railroads. Private manufacturing corporations, it was insisted, are not public agencies and cannot be compelled to keep their shops running or sell their goods to any person who applies. In the next place, it was urged that there was no restraint put upon interstate commerce, and that under the decision in the Knight case the creation of a monopoly in the manufacture of a commodity is not prohibited by the Anti-Trust Law.

The Supreme Court held, however, that Congress may prohibit the performance of any agreement between individuals or corporations where the natural and direct effect of it is to regulate or restrain interstate commerce. In other words, the Anti-Trust Law applies to every agreement in restraint of interstate trade, whether made by corporations or individuals.

In the next place the Court held that any agreement or combination which directly restrains not only the manufacture but the sale of a commodity among the several states comes within the Anti-Trust Law.

Commenting on the Knight case the Court said (page 240):

The case was decided upon the principle that a combination simply to control manufacture was not a violation of the act of Congress, because such a contract or combination did not directly control or affect interstate commerce, but that contracts for the sale and transportation to other states of specific articles were proper subjects for regulation because they did form part of such commerce.

II. QUESTIONS WHICH ARE PENDING IN THE COURTS

Champion *v.* Ames and Francis *v.* United States (Supreme Court)

(*The Lottery Cases*)

These cases arose under the act of March 2, 1895 (28 Stat., 963), which makes it an offence to cause lottery tickets or matter "to be carried from one state to another." The Francis case grew out of the transit of a man carrying a lottery ticket from Newport, Ky., to Cincinnati, Ohio, across an interstate bridge; the Champion case from the carriage by an express company over a railroad, for hire, of a box of lottery tickets from one state to another.

The provision prohibiting the carriage of lottery tickets from one state to another by any instrumentality was designed to supplement the prohibition of the carriage of lottery matter through the mails, and thus make the law effective. Its constitutionality is assailed on the ground that while, under the power to establish post-offices and post-roads, Congress may exclude from the mails lottery matter, it has no authority, under the power to regulate commerce among the several states, to prohibit the carriage of lottery matter from one state to another.

The cases have been argued three times, and are now under advisement.

Those assailing the law insist that a lottery ticket is not an article of commerce, its carriage is not interstate commerce, and therefore Congress has not power to prohibit its carriage from one state to another. It is further contended that even if such carriage be commerce, the power to regulate does not include the power to prohibit.

On the other side, the Government insists that as lottery tickets are commonly bought and sold they are articles of commerce; but even if not, their carriage from state to state is commerce, inasmuch as transit or transportation is not merely a means of commerce, but is commerce itself.

With respect to the second point, the Government contends that the right to regulate includes the right to prohibit,

where the character of the article warrants its exclusion from commerce.

The judgment and opinion of the Court may therefore more clearly define the nature of interstate commerce and the extent of the power of Congress to regulate it.

Since decided, Feb. 23, 1903, in favor of the United States. 188 U. S , 321, and 188 U. S., 375. — Ed.

United States *v.* Northern Securities Company et al.[1]

(United States circuit court, district of Minnesota.)

(Petition filed March 10, 1902.)

In the year 1901 the Northern Pacific Railway Company and the Great Northern Railway Company operated two parallel and competing transcontinental lines of railway, extending across the northern tier of states west of the Great Lakes, from the Great Lakes and the Mississippi River to the Pacific Ocean, each system connecting at its eastern terminals, not only with lines of railway, but with lake and river steamers to other states and to foreign countries, and at its western terminals with sea-going vessels to other states, territories, and possessions of the United States, and to foreign countries, and were then engaged in active competition with one another in freight and passenger traffic among the several states and with foreign countries.

Early in that year, these two railway companies, acting for the purpose of promoting their joint interests, and, as the Government claims, in contemplation of the ultimate placing of the Northern Pacific and Great Northern systems under a common source of control, united in the purchase of the total capital stock of the Chicago, Burlington, and Quincy Railway Company, issuing for that purpose about $200,000,000 of their joint bonds, at the rate of $200 in bonds for each $100 in stock. The Burlington system was about 8000 miles in length, covering the vast region between Chicago and St. Paul on the east, and Kansas City, Denver, Cheyenne, and Billings on the west, and was gradually pushing its rails northwesterly into the territory

[1] The final decision of March 14, 1904, is reprinted in full at p. 322, *infra*. — Ed.

occupied by the purchasers, and westerly toward the Pacific Ocean. It connected with the Great Northern and Northern Pacific systems at St. Paul and with the Northern Pacific system at Billings, Mont., and was in part parallel and competing with the Union Pacific system.

Shortly after the purchase of the Burlington system the controlling stockholders of the Northern Pacific and Great Northern companies organized, under the laws of New Jersey, the Northern Securities Company, with a capital stock of $400,000,000, for the purpose of exchanging its stock for the stock of the two railway companies, at the rate of exchange of $115 of the capital stock of the Northern Securities Company for each share of the capital stock of the Northern Pacific, and $180 of the capital stock of the Northern Securities Company for each share of the capital stock of the Great Northern. The subscribed capital of the Northern Securities was but $30,000 and its authorized capital of $400,000,000 was just sufficient, when all issued, to represent and cover the exchange value of the entire stock of the two railway companies, at the rate agreed upon, which was about $122,000,000 in excess of the combined capital stock of the two railroad companies taken at par.

The suit filed by the Government was against the Northern Securities Company, the two railway companies, and their controlling stockholders, for the purpose of dissolving the merger resulting from the creation of a holding corporation and the turning over to it of the stock of the railway companies.

It is the contention of the Government that, by the creation of the holding corporation and its taking over the stock of the competing railway companies, the individual stockholders of the formerly competing railway companies were to be eliminated and a single common stockholder, the holding company, was to be substituted; the interest of the individual stockholders in the property and franchises of the two railway companies was to terminate, being thus converted into an interest in the property and franchises of the Northern Securities Company. The individual stockholders of the Northern Pacific Company were no longer to hold an interest in the property or draw their dividends from the earnings of the Northern Pacific system, and the individual stock-

holders of the Great Northern were no longer to hold an interest in the property or draw their dividends from the earnings of the Great Northern system, but having ceased to be stockholders in the railway companies and having become stockholders in the holding corporation, both were to draw their dividends from the earnings of both systems, collected and distributed by the holding corporation. In this manner, by making the stockholders of each system jointly interested in both systems, and by practically pooling the earnings of both systems for the benefit of the former stockholders of each, and by vesting the selection of the directors and officers of each system in a common body, to wit, the holding corporation, with not only the power but the duty to pursue a policy which would promote the interests, not of one system at the expense of the other, but of both at the expense of the public, all inducement for competition between the two systems was to be removed, a virtual consolidation effected, and a monopoly of the interstate and foreign commerce formerly carried on by the two systems as independent competitors established.

It is further contended that the Northern Securities Company was not organized in good faith to purchase and pay for the stocks of the Great Northern and the Northern Pacific Railway companies. It was organized solely to incorporate the pooling of the stocks of said companies. It is a mere depositary, custodian, holder, and trustee of the stocks of the Great Northern and the Northern Pacific Railway companies, and its shares of stock are virtually but beneficial certificates issued against such railroad stocks to designate the interest of the holders in the pool.

At the time of the passage of the act of July 2, 1890, the method used to combine competing companies was by placing their stocks in the hands of trustees and issuing trust certificates in exchange therefor. The interesting question in this case is whether substantially the same result can be reached by creating a holding corporation to take over the stock of companies competing in interstate commerce, and thus pool their earnings, consolidate their control, and remove all inducement for effective competition between them.

UNITED STATES *v.* SWIFT & CO. ET AL. (THE BEEF TRUST CASE)

(United States circuit court, northern district of Illinois.)

(Petition filed May 10, 1902.)

This is a bill of complaint, brought by the direction of the Attorney-General, against seven corporations, one partnership and twenty-three persons, constituting what is commonly called "The Beef Trust," engaged in the business of purchasing live stock, converting the same into fresh and cured meats, and selling the products to dealers and consumers throughout the United States and in foreign countries. The bill charges the defendants with being engaged in a combination or conspiracy to restrain trade or commerce in the articles mentioned among the several states and with foreign countries, and to monopolize or attempt to monopolize, the same by a number of different methods which are set out in detail in the bill, to wit, by requiring their agents to refrain from bidding against each other in the purchase of live stock; by collusively bidding up the market price for a time in order to attract shipments of live stock to the yards and then refraining from bidding; by arbitrarily fixing uniform prices on interstate sales of meat, either directly or through their agents, and by lowering or raising such prices; by curtailing the quantity of meats shipped from one state to another; by fixing uniform terms of credit to dealers and uniform charges for cartage, for the purpose of preventing competition in the interstate sales of meat; and by combining to secure rebates on interstate shipments of meat products from the railway companies.

A demurrer, general and special, was filed by the defendants, which was argued on December 16, 1902, and is now under advisement by the court. The contention of the defendants is, that although the live stock may have been purchased in states other than where converted into fresh meats, and the fresh meats sold in states other than where prepared, nevertheless the shipments between these states were in no wise affected by the arrangement complained of, which only touched the live stock at the point of purchase and the meats at the point of sale,

both local. Therefore they insist that no restraint of interstate commerce is shown.

Since decided April 18, 1903, in favor of the Government, holding that such a combination is in effect in restraint of trade. 122 Fed. Rep., 529. The case now awaits argument in the Supreme Court.— ED.

UNITED STATES v. RAILROADS (THE RAILROAD INJUNCTION SUITS)

These are bills in equity, filed by direction of the Attorney-General, against fourteen railroad companies, eight pending in the United States circuit court for the western district of Missouri, and six in the United States circuit court for the northern district of Illinois.

The bills allege that the railroad companies (acting separately) combined with certain favored shippers to grant the latter unlawful rebates or concessions from their published tariffs in rates on grain, carried from one state to another, notwithstanding they maintained their published rates as against all other grain dealers and the general public.

It appeared, from the investigation made, that on each of the principal grain-carrying railroads a different shipper enjoyed this preference. The discrimination was so great that the grain dealer denied the preference could not long continue in the business in competition with the favored one. The effect of the preference was to force those who conformed to the law out of the grain business, leaving the favored dealers to enjoy a practical monopoly of the purchase and shipment of grain on the railroads preferring them.

As the Federal courts have held that, under the interstate-commerce law, a corporation is not indictable, only its officers being answerable for violations, and that unjust discrimination does not exist where no other shipper pays the published rate at the same time the preferred shipper receives the concession, it will be observed that the penal provisions of the interstate-commerce act afford no practical remedy. Even if the act should be amended so as to make the corporation criminally liable, no adequate relief would be afforded to those who wish

to engage in the grain business. To open the business to them, it is necessary to prevent the railroads from granting preferences in transportation rates or facilities.

This being the situation, the bills in equity were filed, in which, after reciting the facts, it is claimed that not only were the acts complained of in violation of the interstate-commerce act, but also were in restraint of trade or commerce among the several states, and constituted an attempt to monopolize such commerce in the grain business, in violation of the act of July 2, 1890.

Temporary injunctions were passed upon by Judge Grosscup in April, 1903, 122 Fed. Rep., 544. The Elkins amendment to the act to regulate commerce had meanwhile been enacted. The right of the Government to maintain a suit in equity was recognized. — Ed.

The railroad companies demurred to the bills, contending:

1. That the remedies provided in the act to regulate commerce are exclusive, and do not include a remedy by injunction at the suit of the Government.

2. That under the general jurisdiction in equity, injunction does not lie to restrain the violation of a law, even if the public is being injured by such violation.

3. That a combination between a railroad company and a shipper to grant the latter an unlawful rebate, which results in establishing a monopoly, is not covered or condemned by the provisions of the act of July 2, 1890; and therefore the remedy by injunction will not lie under the law.

The demurrers were argued December 15, 1902, before the judges (sitting together) of the two circuit courts, and are now held under advisement.

Montague & Company *v.* Lowry

(Error to the circuit court of appeals for the ninth circuit.)

(193 U S Rep., 38. Decided February 23, 1904.)

An association was formed in California by manufacturers of and dealers in tiles, mantels and grates; the dealers agreed not to purchase materials from manufacturers who were not members, and not to sell unset tiles for less than list prices, which were fifty per cent higher than to members. Manufacturers,

resident in other states than California, agreed not to sell to any other than members. Membership was prescribed by rules, such as carrying $3000 worth of stock. A firm of outside dealers who were not members, and who did not carry $3000 worth of stock, brought action under § 7 of the Anti-Trust Act of 1890. It was held, that although sales within the state were but a small part of the total transactions involved, the general effect of the scheme was to enhance prices; and that it was impossible to separate intra-state from inter-state business; and that a combination in restraint of trade had been shown. The parties aggrieved were entitled to recover threefold damages as found by the jury. — ED.

III. SUGGESTIONS RESPECTING LEGISLATION

I come now to your invitation to communicate to the committee "any suggestions that your reflection or experience shall suggest as to what may be desirable in the way of further legislation."

In view of the wide experience of the committee in dealing legislatively with legal and economic questions, I venture upon the line of suggestion with much hesitation and feeling that the utmost the committee desires in this respect is that some concrete thing be set down that may be considered, in connection with other views that may be presented, as to what might be done within the short period allowed for consideration during the life of this present Congress.

I think it proper enough to briefly premise such suggestions as I shall make for immediate action by a statement of some of the reasons upon which they are based.

The end desired by the overwhelming majority of the people of all sections of the country is that combinations of capital should be regulated and not destroyed, and that measures should be taken to correct the tendency toward monopolization of the industrial business of the country. I assume a thing to be avoided, even by suggestion, is legislation regulating the business interests of the country beyond such as will accomplish this end.

In my judgment, a monopoly in any industry would be impossible in this country, where money is abundant and cheap and in the hands or within the reach of keen and capable men,

if competition were assured of a fair and open field and protected against unfair, artificial, and discriminating practices.

Two or more persons or corporations cannot by any combination or arrangement between themselves either contract or expand the rights of others to engage in a similar business. The utmost they can do is to discourage the disposition to do so by restricting the opportunities, or by securing to themselves some exclusive facilities or the enjoyment of some common facilities upon exclusive terms.

If the law will guarantee to the small producer protection against piratical methods in competition and keep the highways to the markets open and available to him for the same tolls charged to his powerful competitor, he will manage to live and thrive to an astonishing degree.

Individualism in production has its advantages as well as combination. Small individual enterprises not uncommonly spring up and thrive within the shadow of the larger ones, though enjoying none of their supposed advantages of control of sources of raw material, fuel, and transportation facilities, yet realizing large profit per ton of output because of the closer economies possible through direct, personal, interested management. Indeed, it is true that the great concerns whose stocks have been gathered in by the holding companies (the real trusts) are themselves largely but aggregations of successful smaller ones which, one by one, have made their competition so severely felt by an ambitious rival that he has absorbed them.

I believe the rebates and kindred advantages granted by carriers to large operators in the leading industries of the country, as against their competitors, in many years amounted to a sum that would represent fair interest upon the actual money invested in the business of such operators.

If substantially all of a given business is controlled by one company, the more threatening to potential competition does this iniquity become, and with greater timidity does such competition approach the field.

In some respects the holding company is weaker than its independent rivals. It pays as much, if not more, for labor. Advantage in the saving of an intermediate profit upon raw

material and fuel is largely offset by the enormous cost of the sources of supply represented in high capitalization.

This capitalization, in almost every case of a holding company, represents far more than the aggregate intrinsic value of its constituent companies. The method of computing values for purpose of concentration has invariably been upon earning power, and rebates have frequently swelled earnings so that enormous volumes of capital stock represent nothing but unfair advantage obtained over rivals.

The situation is much improved in respect to transportation discriminations within the last two years. This is the result, first, of a determined effort upon the part of the Government to apply existing laws in an effective way against discrimination; and second, to the fact that some of the higher-minded railroad managers of the country have exerted their large influence in the direction of equitable dealing with the shippers of the territory which they serve. Whether it is a consequence of these influences or a mere coincidence, it is nevertheless stated on high authority to be a fact that the embarkation of new capital in enterprises in competition with the supposedly controlled industries within the period named probably equals the capital of the trusts. The effect of certainty of protection against predatory competition can be safely prophesied to increase this figure.

The country is filled with men whose lives have been devoted to industry, who have developed and made profitable the properties now possessed by the trusts at prices far in excess of the cost of modernized duplicates, who will not long remain idle when assured that their capital and experience can be securely employed in the business to which they were trained.

Too much has been conceded in public discussion to the trusts in this respect. Organizations in one state to control production in other states of commodities consumed in all the states are as a rule devices of shrewd men to capitalize for their own benefit the country's prosperity. They are begotten in prosperous times. Poor times offer no inducements. They are essentially different from the combinations effected by producers, of their own motion, for economic reasons. Those which have been

recklessly conceived contain within themselves the germ of their own undoing. They have, as a rule, only acquired the ownership of the stocks of the industries of the country which had already attained their gigantic stature. Their existence does not increase the productive capacity of the country, except as high prices of products have stimulated competition, nor have they because of their existence increased demand, as the demand for products has never been thought to depend upon the title to capital stocks of producing companies.

My suggestion, therefore, is that as a first step in a policy to be persistently pursued until every industry, large and small, in the country can be assured of equal rights and opportunities, and until the tendency to monopolization of the important industries of the country is checked, that all discriminatory practices affecting interstate trade be made offences to be enjoined and punished. Such legislation to be directed alike against those who give and those who receive the advantages thereof and to cover discrimination in prices as against competitors in particular localities resorted to for the purpose of destroying competition in interstate and foreign trade, as well as discrimination by carriers.

Such practices are so obviously unreasonable that to inhibit them would be a measure of regulation of commerce to keep it free and unrestrained and not an attempt to exercise arbitrary power. Such legislation, to certainly reach producers guilty of practices injurious to national and international commerce, should, in my judgment, take the form of penalizing the transportation of the goods produced by the guilty parties, and the Federal courts should be given power to restrain such transportation at the suit of the Government.

It may be said that under the "act to regulate commerce," a shipper may be punished for receiving rebates or special rates less than the lawful published rates; and that it is unnecessary to provide additional legislation in this respect to curb trusts, monopolies, and combinations. This, however, is an erroneous statement.

Whatever the Congress may have designed in the act to regulate commerce regarding the punishment of shippers for partici-

pation in violation of that act, as construed by the courts, their punishable offences fall under two heads:

First. Where the shipper has solicited or participated in instances of unjust discrimination, and

Second. In cases of fraud perpetrated by him against the carrier, ex. gr., by false representation of the contents of a package.

As to the first, the courts have held that to constitute unjust discrimination it is necessary to prove that at the time the lower unlawful rate was being granted to the favored shipper, the higher lawful rate was imposed against another shipper on like commodities between the same points.

In many cases of departure by a carrier from its published tariffs, the favored shipper has enjoyed his advantage for so long a time that all rivals have disappeared. In such cases, and they are the most numerous, no illegal discrimination exists; consequently the recipient of the unlawful rebates escapes the penalties of the act to regulate commerce.

The act prohibits the carrier from charging any one a greater or less rate than the rates named in its schedules; but the penalties provided therefor have been held by the courts not to be applicable to any carrier that is an incorporated company.

The officers or agents of such incorporated company, who grant the rebate or make the unlawful concession in rates, are subject to indictment and punishment. That, however, is generally an impracticable remedy, because the agent who makes the concession is usually the only person by whom it can be ascertained that the rebate has been paid; and when he has testified in relation to the matter he has thereby obtained amnesty from prosecution.

Even if the corporation and its officers could be effectively reached by criminal proceedings, the law leaves unrestrained the persons, corporations, and combinations who are beneficiaries of the unlawful rebates.

This *casus omissus* of the act to regulate commerce should be supplied by imposing a penalty upon the incorporated carrier and beneficiary alike, and the right of courts to restrain such practices at the suit of the United States, a right not settled and now vigorously challenged, should be made certain.

I think the operation of such an act should be limited to the transportation by common carriers subject to the act to regulate commerce. This is necessary for the reason that there is no requirement of law that rates shall be published by common carriers, except by railroad, or railroad and water, carriers acting as one line. When the act to regulate commerce was under consideration it was deemed impracticable if not unwise to attempt to regulate the rates of water or other common carriers. It was understood that in the nature of things water rates could not be stable.

In addition to that it was believed that water competition must be unrestricted. As it is the least expensive means of transportation, it, wherever it could directly or indirectly compete with carriers by rail, would, approximately, furnish a basis for rates by railroad, and measurably keep such rates within the limits of extortion.

So that if provision is made by law to prevent rebates, a standard or established schedule must be referred to; and as the admitted abuse of magnitude has been in the favors granted by railroad companies, their rates, which the law requires shall be made public, should be taken as the rates which must be adhered to and made equal to all the people under similar conditions.

It should, therefore, be made unlawful to transport traffic by carriers subject to the "act to regulate commerce" at any rate less than such carriers' published rate, and all who participate in the violation of such law should be punished.

An additional provision should be made to reach corporations, combinations, and associations which produce and manufacture wholly within a state, but whose products or sales enter into interstate commerce. It should relate, first, to such concerns as fatten on rebates in transportation, and, second, to concerns which sell below the general price of a commodity in particular localities, or otherwise in particular localities wantonly seek to destroy competition. These could be excluded with their commodities, products, or manufactures from crossing state lines.

As the power of Congress over interstate commerce is plenary, excepting as it may be limited by the Constitution, it is believed

that it may impose such a punishment for the violation of the public policy of the nation.

A comprehensive plan should be framed to enable the Government to get at all the facts bearing upon the organization and practices of concerns engaged in interstate and foreign commerce essential to a full understanding thereof and to compel the observance of the law. This should be framed upon tested lines.

A commission should be created to aid in carrying out the provisions of the act of July 2, 1890, and any further legislation relating to commerce. It should be the duty of such commission, among other things, to make diligent investigation into the operations and conduct of all corporations, combinations, and concerns engaged in interstate or foreign commerce, and to gather such information and data as would enable it to make specific recommendations for additional legislation for the regulation of commerce, and annually, and oftener if it shall seem needful, to make report thereon to the President.

Such a commission should have authority to inquire into the management of the business of such corporations and concerns, to keep itself informed as to the manner and method in which the same is conducted, and to obtain from such concerns full and complete information necessary to enable the commission to perform the duties and carry out the objects for which it is created; it should have the power, when in its judgment it is necessary, to require reports from them and to require from them and their officers, agents, and employees specific answers to all questions upon which the commission needs information. As there are no means now provided by law for compelling testimony, such a law should provide that no person should be excused from attending and testifying or from producing books, papers, contracts, and documents before such commission or the courts.

Of course, the general scheme of legislation to correct trust abuses should be developed with great care, for it is not nearly so important to act quickly as to act wisely. Primarily, the question of the power of Congress to reach what the Sherman Act seems to have missed should be authoritatively determined,

as upon that proposition the whole structure of effective regulative legislation must rest. We should at once take the first steps by a law aimed at what we certainly know to be unreasonable practices directly restrictive of freedom of commerce upon which the fundamental question can be raised, and by a law conferring upon the Government a general supervisory power as above outlined.

Another step in legislation which I earnestly recommend, and which will, if enacted, greatly hasten a solution of the problem, is that an act be passed as soon as possible to speed the final decision of cases now pending and others that may be raised under the Anti-Trust Law. I refer to an act to enable the Attorney-General to secure the original hearing by a full bench of the circuit judges in the circuit wherein is pending any suit brought by the United States under the Anti-Trust Law which the Attorney-General certifies to the court to involve questions of great public importance, and giving an appeal from their decision directly to the Supreme Court of the United States in such cases, and also giving an appeal directly to the Supreme Court in all pending cases in which the United States is a party which have been heard and are as yet unappealed.

There are a number of cases now provided by statute where appeals may be made directly to the Supreme Court from the district and circuit courts, namely, in cases in which the jurisdiction of the court is in issue, from final sentences and decrees in prize cases, in cases of conviction of a capital or otherwise infamous crime, in cases that involve the construction or application of the Constitution of the United States, in cases in which the constitutionality of any law of the United States, or the validity or construction of any treaty is drawn in question, and in cases in which the constitution or law of a state is claimed to be in contravention of the Constitution of the United States.

The class of cases that I suggest should be brought within this rule, it seems to me, is of as great importance as any of those referred to. The suggested provision requiring a full bench of the circuit judges would insure the cases receiving as full consideration before presentation to the Supreme Court as if heard by the United States circuit court of appeals.

It is too much to say that with these gaps closed the scheme of governmental regulation will be complete; but it is clear that without some similar legislation it would continue to be inadequate. And such legislation will make a long, first stride in advance.

Very respectfully yours,

P. C. KNOX,

Attorney-General.

XIII

THE TIN-PLATE INDUSTRY[1]

I

BY tin-plate is meant a sheet of iron or steel varying in thickness from 22 to 30 wire gauge coated with tin. In the language of the trade, plates before they are covered with tin are referred to as "black plates." These plates are made in several sizes, but the standard is a plate 14x20 inches and when coated with tin is placed in a box containing 225 sheets.[2] These boxes weigh 108 lbs. Besides the regular commercial tin-plate is another commodity made by the mills which is called "terne plate." A terne plate is an iron or steel sheet covered with an alloy of lead and tin, generally two-thirds lead and one-third tin. The terne plate is used very largely for roofing and cornice purposes.

The method of manufacturing tin and terne plates is rather simple so far as the process is concerned, but a great deal of skill is required to turn out good plates. The process begins with the rolling of thin sheets from billets of steel especially prepared for the industry. When the required thickness has been reached the plates are sheared to a size and made ready for pickling. A plate is pickled when placed in a bath of sulphuric acid and water. This process clears the sheets of scales. When taken out of the pickling bath the plates are rinsed free of the acid and packed in pans with layers of sawdust between the plates. The pans are then carefully sealed and put in an annealing furnace, where they are allowed to remain for ten hours. The heat of the furnace is gradually reduced and the plates allowed to cool slowly. A second rolling is now neces-

[1] From the *Yale Review*, November, 1898, and August, 1899.

[2] Called by the trade IC, 14x20, and weighing 50 lbs. or less per 100 sq. ft. Other grades are IX, weighing between 50 and $62\frac{1}{2}$ lbs.; and IXX, weighing 63 lbs. per 100 sq. ft.

sary. This is done by passing them through three sets of cold steel rollers. Another sulphuric acid bath and annealing are undertaken and the plates are ready for tinning. In the tinning department the plates are first coated with grease, then dipped into the tinning pot, taken out and placed in a bath of molten tin. The plates are brushed, again greased and passed through melted tin for a third time. The plates are now allowed to cool, carefully wiped free of grease, assorted and packed in boxes according to quality. This is the process of tin-plate manufacture.[1]

The tin used in the process comes from several sources. The best of these is found in Australia and the Straits Settlements. The latter furnish the most desirable tin, known as Banca tin. This is regarded as the purest, and is in consequence more sought after by the manufacturers of tin-plate. The Cornwall mines were discovered about 55 B.C. and for twelve centuries were the one source of this mineral. In 1240 tin was found in Bohemia. Five hundred years later, in 1760, the Banca mines were opened. In the following century Australia became a producer of block tin on a large scale. From 1872 tin has been found in commercial quantities in New South Wales, Queensland, and Tasmania. The United States have not been so fortunate, although many attempts have been made from time to time to find tin. Tin was discovered in California as early as 1840, but there was no mining done until 1868. Only for a short time were the mines operated; they were then closed down, and remained so until 1888. In this year an American company bought the property with the intention of operating, but it was sold to an English syndicate before two years had passed.[2] Something like $800,000 were spent, but no special results were secured. The total product of the mine was 269,000 lbs. of tin valued at $56,000.[3] The Harney Peak mine is the story of another futile attempt to get tin in commercial quantities. The Harney Peak, as it is familiarly called, is situated near Custer City, S. D. A great deal of money has been spent in the development of this mine, but it is doubtful if

[1] Senate Ex. Doc., 52 Cong., 1 Sess., Vol. 6, No. 102, p. 11. J. D. Weeks in Tin-Plate Industry, Pittsburg, 1892.

[2] Senate Ex. Doc., 52 Cong., 1 Sess., Vol. 6, No. 102, p. 45.

[3] Mineral Industry, Vol. I, p. 542.

more than ten tons of metal have been taken out of the ground.[1] The English capitalists were also heavily interested in this attempt. In Alabama, North Carolina, and Virginia tin-bearing rock has been found. In no sense can the United States be regarded as a tin-producing country.[2]

The cost of mining tin varies with locality, kind of labor employed, and character of the ore. The average cost of breaking and selecting ores in the Cornish mines is from 4*s*. to 8*s*., per ton of ore; the depreciation of machinery is estimated at 2*d*. The total mining charges average £12 to the ton of tin, the dressing costs £9, and management, expense of buildings, and wear and tear on machinery carry the amount to £35 per ton of tin. This statement of cost is not altogether accurate, but is probably very near the truth. Banca mines have the advantage of cheap labor. The price paid there for experienced labor is £1 per month. The workmen average twelve hundredweight of metallic tin per year.[3] The yield of the Cornwall mines is about 20 per cent of the tin ore or 45 lbs. of tin to the ton of ore.

Before the ore is ready for reduction to pig tin, the sulphur and arsenic must be driven off by roasting the ore. This requires from twelve to eighteen hours. The consumption of fuel for refining is thirty to thirty-five hundredweight per ton of metallic tin. The tin of the Banca mines is almost pure, so that it has a decided advantage in cost of production. Although England is so near to the Cornish mines the price of block tin in London is about the same as in New York. The prices given on March 4, 1898, at New York, per long ton of 2240 lbs., was $310.44. At London Straits tin (Banca) was sold for $311.10.[4] It will be seen from this statement that the manufacturers of tin-plate in England have no particular advantage over the American producers so far as the raw material is concerned. It might be

[1] *Supra*, *Ibid*.

[2] The total tin production of the world in 1895 was estimated at 186,786,880 lbs. Of this amount the United States imported 54,252,045 lbs., or 29 per cent, at a valuation of $7,405,619. See U. S. Geological Survey, 1895; Mineral Industry, Vol. I, p. 457.

[3] Tin and Terne Plate, J. D. Weeks, p. 13.

[4] The prices given above are taken from the Monthly Summary of Finance and Commerce of the U. S., Feb 1, 1898, pp. 1207, 1218. The price in New York was 14.35c. per pound, and £64 16*s*. 3*d*. per ton in London.

urged that the Cornish mines undersell the Straits, but the fact is that Cornish mines are not able to supply all the English demand for tin. Naturally the price of tin is governed by the price of Straits tin.

II

The United States have always been a large consumer of tin-plate. In 1892 this country was taking 60 per cent of the English production of the commodity. A remarkable falling off in the imports occurred in 1898. This decline began with the tariff legislation of 1890. The table below tells the story more forcibly than words can.

IMPORTATIONS OF ENGLISH TIN-PLATE

1893	628,425,902 lbs.
1894	454,160,826 "
1895	508,038,938 "
1896	385,138,983 "
1897	230,073,683 "

A similar decline has taken place in the imports of black plates not yet tinned, as indicated in the following table:

IMPORTATION OF ENGLISH BLACK PLATES

YEAR	LONG TONS	POUNDS
1893	—	—
1894	—	—
1895	8914	19,967,560
1896	3128	7,006,720
1897	689	1,554,360
1898[1]	171	381,040

The demand as well as the consumption of tin and terne plates has not decreased in any way, so that the source of supply must be looked for elsewhere than in England. This demand is therefore largely supplied by the American industry. The statement here made is further upheld by the fact that in 1892 some 13,642,719 lbs. of tin-plate were made in the United States, 31 per cent of which was manufactured from foreign black plates. The amount had increased enormously in 1897, so that 446,982,063 lbs. were produced, and of this amount only

[1] January and February, 1898. Tin and Terne, March 24, 1898.

one per cent was made from foreign black plates.[1] These facts certainly indicate the existence of a rapidly growing industry.

Leaving the matter of the tariff out of consideration for the time being, the United States were handicapped in the early history of the industry by the high price of labor, the lack of technical knowledge concerning the industry, and the distance of iron ore from fuel. These difficulties have been overcome in some measure. The industrial depression from 1892–97 was a decided aid to the growing industry. The wages of labor fell about 15 per cent in this period, although there is a marked tendency at present to recover from the decline. The fall in the wages of labor placed the English and American makers more nearly on a basis of equality. As a general thing, American labor is quicker and works harder than even the English workingman. This does not hold true in the tin industry. The reduction in wages just referred to was not sufficient of itself to make up differences in cost. According to Sir R. Griffen, the Welsh laborer averages £1 2*s.* 5*d.* per week, equivalent to $5.46, while in Pennsylvania the wages average $10.68 per week.[2] The higher American wages are not accompanied by an increased efficiency of labor. Taken all in all, the Welsh producer makes tin-plate about 30 per cent cheaper than the American, but the latter when purchasing from the former has never got the benefit of the $2.20 per box cost. Tin can be delivered in New York, freight paid, for $2.49 per box[3] by the English merchant. Tin never reached this point until the Americans began to make it.

The knowledge of the method of manufacture had also to be acquired. This gave for a while an additional advantage to the English makers. The distance of ore from fuel was another question involving delay and expense. In this matter the last five years have seen a remarkable improvement. Ore is now mined by steam shovels and then conveyed in steel barges to the ports of Lake Erie, where it is sent by rail to the smelters. The old method of bringing fuel to the ore has been abandoned, the ore is now brought to the fuel. Lower freight

[1] Report of Special Agent Ayer, January, 1898, Treasury Department, p. 8.
[2] Eng. Foreign Office Report, Mis. No. 26, p. 10. [3] *Ibid.*, p. 11.

rates have made this possible. So cheap has steel become in this country through these various processes and changes that it is now exported to England.[1]

In the cost of steel bars (Bessemer) the tin-plate makers of the United States had an advantage over the English of about 20 per cent in April, 1896.[2] In March, 1897, the price ranged from $15 50 per ton to $16.00.[3] As the price has not materially changed the advantage still remains. Mr. J. D. Weeks, in an article on the Tin-Plate Industry, referred to above, gives four statements of cost of manufacture in Wales. An English correspondent gives one, placing the cost of making a box 14 x 20 I C tin-plates at 13*s.* 4*d.* The United States Consul gives another estimate, placing the cost at 11*s.* 9.6*d.* Still another statement is made in which 12*s.* 2½*d.* is regarded as the expense of production. The most conservative and reliable report, which proves to be that of a former manufacturer of tin-plate, fixes the cost at 12*s.* 6*d.* This last amount is equivalent in our money to $3.11. A deduction of 18 cents should be made from this amount for saving in waste, making the cost equivalent to $2.93.[4] This estimate is rather old. Since its

[1] Eng. Foreign Office, Mis. Rep. No. 426, p. 5.

[2] Price steel bars (Bessemer) U. S., $15.50 per ton = £3 2*s.*
" " " England, " £3 17*s.*

[3] Monthly Summary U. S. Commerce, p. 1212.

[4] J. D. Weeks, Tin-Plate Industry, 1892, p 22

STATEMENT OF COST

Steel bars at works, 136 lbs. at £4 15*s.* per ton	$1.39
Block tin	.62
Sulphuric acid	.10
Flux for tinning	.01
Coal for steam and heating works	.16
Costing for general repairs	.04
Clay, brick, lumber for boxes	.08
Nails, hemp, skin brushes, bran	.01½
Palm oil	.06
Other items not enumerated	.04½
Material	$2.52
Labor	.58½
	$3.11
Credit for waste	.18
	$2.93

date, 1878, a great many improvements have been made in machinery, and the cost of steel has been reduced very materially. With the cost of steel just given the expense of production would be cut down to $2.56. The improved machinery will still further reduce this price to the one now ruling in England, $2.20. As will be remembered, the American wages averaged about twice those paid in Wales. This will materially increase the cost of the American product, so that it is not likely that American tin-plate is manufactured under a cost of $2.75 per box for first-class material. The present price of tin-plate in this country leaves a margin of 75 to 85 cents per box for our producers. When the commissions and profits of middle men are taken from this, it will be seen that tin-plate is being sold close to cost. If this is true, an adjustment of prices to the industry and the demand must follow which will again give the English industry some hope of entering our markets.

Properly equipped machinery was difficult to secure at first. This part of the problem has been met by inventions and improvements over the English machines. In this matter it is probable that the Americans have been most successful in reducing the expense. The preparation of steel is the best example. In tinning machinery the advance has been much slower and less satisfactory. Under the English system the mills are run by one central engine, while in this country the tendency has been to run an engine for each set of mills. This increases the expense for coal and adds to the cost of manufacture, but gives greater efficiency. The mills in the United States are better built and can do more work. It remains to be seen whether the industry will warrant the elaborate preparations which have been made.

III

The legislation for the establishment of the tin-plate industry rests upon three ideas: first, that seventy millions of people should not depend upon Welsh works for tin-plate; second, that the foreign tin-plate is poorly made and does not meet our particular wants; third, that the country needs a new industry in which more labor can be employed. In these three state-

ments we have a blending of the commercial, the economic, and the political. So long as the foreign makers possessed a monopoly, they refused to listen to any suggestions from this side of the water concerning the improvement of their plate. There were also times when the foreign dealers took advantage of the scarcity of tin-plate in this country to force up the price. This attitude naturally influenced very considerably the American mind. Behind the scenes another class, the men who owned supposed tin mines, endeavored to secure the attention of Congress. They were anxious that the tin-plate industry should be encouraged, provided that block tin was put on the tariff list. Manufacturers of steel were ready to make tin-plates if adequate protection was given them. When the various elements, just mentioned, were coupled with public opinion, which after all was public indifference, and brought to bear upon Congress, the necessary legislation was forthcoming. The new industry having received these necessary conditions, it was considered that time alone was all that was needed to bring it into full fruitage.

Previous to 1890 block tin had been on the free list for twenty years, while tin-plate had been subject to a duty since 1864. Under the tariff of 1883, no tin-plate was produced in this country. The consumers of the article paid $35,000,000 in duties for the support of an industry that did not come into existence.[1] The probable reason for the failure to establish an industry was the lack of facilities for making steel plates. In addition to this the financial condition of the country hardly warranted any extension of enterprise. The tariff of 1864 placed a duty of 2½ cents per pound on "all imports of tin-plates and iron galvanized, or coated with any metal by electric batteries or otherwise." The Treasury Department so construed the law that a duty of 15 per cent "ad valorem" was substituted in the place of the original amount.[2] Although the protection thus given was low, nevertheless several plants were built in the hope that the high price then ruling would continue. It did not do so, and the plants were forced out of the business.[3]

[1] House Reports, 52 Cong., 1 Sess., Vol. 4, No. 1040. [2] *Ibid.*

[3] Plants were established at Wellsville, Ohio, 1872; Leechburg, Pa, 1873; Demmler, Pa., 1875.

There was no real effort to manufacture tin-plate until the McKinley Bill was adopted. This act received the sanction of Congress October 1, 1890. The clause relating to tin went into effect July 1, 1891. It was declared that after that date tin and terne plates should pay a duty of 2.2 cents per pound instead of one cent as before. The very significant addition was made that "after October 1, 1897, tin and terne plates lighter than 63 lbs. per one hundred square feet should be admitted free of duty, if it shall be made to appear to the satisfaction of the President that the aggregate quantity of such plates lighter than 63 lbs. per one hundred square feet, produced in the United States during either of the six years next preceding June 30, 1897, has equalled one-third the amount of such plates imported and entered for consumption during any fiscal year after the passage of this act and prior to October 1, 1897."[1] Several conditions were added to this part of the bill with the intention of making out the highest production and the smallest importations. Under the rule of the Treasury Department it was permissible to compare the highest production of any one year with the lowest importation of any single year. Imported plates upon which a drawback had been received, when exported in the form of manufactured articles, were not to be counted as importations. On the other hand, black plates when imported for tinning and coated in this country were to be regarded as part of the country's product. The miners of tin were not forgotten in the bill. A duty of four cents per pound was placed on pig tin. The provisions of this part of the act were to take effect July 1, 1893, and to continue in existence two years. If at this time it could be shown that the production of block tin had reached five thousand tons, the duty was to be continued.

Many protests were made against this legislation before and after the enactment of the bill. The Tin-Plate Consumers' League, consisting of the representatives of the canning, oil, and manufacturing interests, sent delegates to the House Committee of Ways and Means.[2] Soon after the passage of the McKinley Act the Republicans were defeated in the Congressional elec-

[1] McKinley Bill, Oct. 1, 1890

[2] House Reports, 52 Cong., 1 Sess., Vol. 4, No. 1040.

tions. Naturally the opponents of the tinning classes hoped that some reactionary legislation would be brought about, and this change in the character of Congress encouraged the interests above mentioned to appear before the committee. Several attempts were made to alter the bill, and these furnished occasions for the appearance of various delegates before the Committee on Ways and Means. The introduction and the consideration of a bill to reduce the duty on tin-plate to one cent until October 1, 1894, after which date the articles should be admitted free, fairly represents the views held in Congress on the subject.[1] Two reports were presented by the House Committee. The majority report upheld the bill on the ground that little or no tin-plate had yet been produced, and that the legislation thus far resulted in the forestalling of the market and produced a speculation in prices ruinous to consumers. In support of these arguments the statements of companies and business firms were quoted in the majority report. These all showed higher prices and a very small manufacture. The minority report was a vindication of the tariff and the need of such an industry. It was shown that in the twenty years from 1871–91 the consumers of tin had paid foreigners $307,341,404, exclusive of freights and importer's profits, for tin and tin-plates. The bill finally reached the Senate Finance Committee, but was never acted upon.[2]

A similar attempt was made to reduce the tariff on block tin. On February 27, 1893, a bill was introduced by the House Committee of Ways and Means to admit free of duty on and after July 1, 1893, imports of bar, block, and pig tin, cassiterite or black oxide of tin.[3] The committee presented with the bill much evidence to show that the then existing price of raw tin was a hardship to consumers. The canning interests found that they were compelled to pay $1.15 per dozen of one quart cans in 1893 as against 70 cents in 1890. In this connection the statement of Mr. Schiver, president of a Baltimore canning company, was offered by the committee as evidence. Mr. Schiver stated that up to February, 1893, he was unable to secure any Ameri-

[1] House Reports, 52 Cong., 1 Sess., Vol. 4, No. 1040.
[2] *Nation*, March 16, 1893.
[3] House Reports, 52 Cong., 2 Sess., Vol. 3, No. 2583

can plate, and that he was now paying 33 per cent more for tin goods than was asked in Europe.[1] The evidence of the committee, together with their favorable report, were not sufficient to persuade Congress to make the bill a law. The Senate as well as the House was besieged with memorials praying for the repeal of the duty on block tin.[2] But to no purpose. The McKinley Bill was not modified until the Republican Congress had been superseded by a Democratic majority. This change occurred in the fall of 1893.

The Wilson Bill of 1894 reduced the rate on tin and terne plates from 2.2 cents per pound to $1\frac{1}{5}$ cents per pound, and block tin was placed upon the free list. The Democratic Congress soon after gave place to a Republican one, and the Dingley Bill of 1897 again modified the tariff on tin so that the rate was placed at $1\frac{1}{2}$ cents and block tin allowed to remain on the free list.

The act of 1890 was the creator of the tin-plate industry. The incentive from it was sufficiently great to draw a good deal of capital into the field. Although the legislation since then has made a lower rate, nevertheless the industry was well enough established in the years intervening between 1890 and 1894 to retain its place and to grow. The elements of growth more powerful than legislation, in the opinion of the writer, were the low prices of steel and wages existing during this period.

It remains to test this industry on the following points: (1) growth of production, (2) reduction of imports, (3) number of plants, (4) comparison of prices, (5) effect on foreign manufactures, and (6) probability of continued growth. This will be done in the final section of our study.

IV

1. The special agent of the Treasury Department in a report of April 26, 1892, states that "the firms replying to his inquiry

[1] House Reports, 52 Cong., 2 Sess., Vol. 3, No. 2583.
[2] Senate Mis. Doc., 52 Cong, 2 Sess., Vol. 1, No. 55.

declared that they had manufactured no tin-plates as yet."[1] The report of the same agent gives for the year ending June 31, 1892, thirteen million pounds as the product of American tin-plate. The industry evidently did not get well started until the middle of the year, 1892, but from that time the output has steadily increased. The table given below indicates the rapid development of the industry. The yearly production of tin-plate now reaches nearly five hundred million pounds. The

PRODUCTION OF TIN-PLATE IN THE UNITED STATES

Year	Pounds	Per Cent from Foreign Plate
1892	13,646,719	31.88
1893	99,819,212	56.32
1894	139,223,467	38.26
1895	193,801,073	17.15
1896	307,228,621	1.38
1897	446,982,063	.01

— From Special Report to Treasury by Ira Ayer, Jan. 28, 1898.

decline in the importation of black plates shows the ability of manufacturers to furnish these for tinning purposes. In 1893 over half the black plates from which tin and terne plates are made were furnished by foreign mills. This ratio has so far declined that in 1897 almost none of the American tin-plate was made from imported plates.

2. The decline in the imports of tin and terne plates has been as rapid and as marked as the increase in the production. The people of the United States consume between six and seven hundred million pounds of tin and terne plates each year. At times the importations for a single year have gone above this mark. The fear of tariff legislation and the intention of avoiding any increase in the duty were the causes of such heavy shipments. Two years are particularly noticeable in this particular, 1890 and 1891.

[1] Senate Ex. Doc., 52 Cong., 2 Sess., Vol. 6, No. 102.

IMPORTS OF TIN AND TERNE PLATES

YEAR	POUNDS
1890	737,935,079
1891	734,425,267
1892	600,819,566
1893	628,425,902
1894	454,160,826
1895	508,038,938
1896	385,138,983
1897	230,073,683

— United States Custom House Reports.

Of the six hundred and seventy-seven million pounds consumed in the United States in 1897 nearly two-thirds were manufactured within its borders. When this statement is compared with the fact that no tin and terne plates were made in this country in 1890, the growth of the industry seems almost marvellous.

3. March, 1898, saw forty-one plants operating 235 mills engaged in the industry.[1] The capital invested is variously estimated from three to five million of dollars. The number of persons employed has been placed as high as fifty thousand. The Congressional estimate at the time of the Wilson Bill was twenty-four thousand, but this is also too large.[2] It is not likely that over eighteen thousand persons are connected with the industry. But even this number is large when the short existence of the industry is taken into consideration.

4. During the last two years the price of Bessemer tin-plates IC 14 x 20, 100 lb. box, has been from \$3.60 to \$3.85 at New York.[3] In the period from 1880–90 the price for the same kind of tin varied from \$5.37½ to \$7.[4] During the same period the price at Liverpool ranged from 15*s*. 6*d*. to 34*s*.[5] The price in 1890 was much less than this last quotation. On the basis of our money the English price was \$3.71 to \$9.16. During the last eight years the price of tin-plate in this country has steadily declined. The tariff is \$1.62 per box of 108 lbs., and

[1] *Tin and Terne*, March 24, 1898.

[2] House Reports, 52 Cong., 2 Sess., Vol. 3, No. 2583.

[3] Monthly Summary of Commerce of the U. S., February, 1898, p. 1215.

[4] Senate Ex. Doc., 52 Cong., 1 Sess., Vol. 6, No. 102, p. 38.

[5] *Ibid.*

in consequence English plates are now delivered in New York at just this sum below the prices ruling in the United States. Although it is now possible to buy English plates at this very low rate, it is not at all certain that such would have been the case if the present industry had not come into existence. Comparison with prices previous to 1890 fully warrants this statement. Two dollars and thirty-seven cents are about the minimum price for plates delivered at Liverpool. The ocean freight will average 13 cents per one hundred pounds. Add to these items the tariff charge of one dollar and sixty-two cents and the price of English plates reaches $4.12 for the American consumer. Mr. Cronemeyer, the president of the American Tin-Plate Association, stated before the House Committee of Ways and Means that three dollars and forty-five cents left a moderate profit for first-class tin-plates.[1] On this basis the American consumer pays ninety-five cents more per box than he would for the English plate provided no tariff existed. At the same time it is true that the price of English plates would be higher than $3.75 per box if this industry had not come into existence.

The *Tin and Terne*,[2] commenting on the condition of the market, says, "The market has continued very unsettled and unsatisfactory to both buyer and seller alike. War and rumors of war, trusts and rumors of trusts, all have a disturbing influence, and in no branch of metal industry have prices been as unsettled and as confusing as in tin-plates. There is a wide range between the high seller and the low seller on spot goods to-day, and a wide difference of opinion in regard to the future market. The Indiana mills are fairly well sold up, and are rather firm in their views; while the Pittsburg mills, it is reported, are seeking business for delivery after July at prices lower than anything hitherto made. It is reported that some very large sales — 100,000 boxes — have been closed in the last few days at a basis below $2.70 per box."

The statement given above is a forecast of the future condition of the industry. The truth of the matter is that already there are more than enough mills to supply the market. Just how far the demoralization may extend is difficult to say, but it

[1] Eng. Foreign Office Report, Mis. No. 426, p. 9. [2] March 24, 1898.

is more than likely that American plate will fall below the three-dollar line. If this happens, we may look for repeated attempts to organize trusts and to close down some of the weaker plants. A period of readjustment will follow, and higher prices again prevail.

5. The establishment of the industry has had a marked effect upon foreign makers of tin-plate. This is well illustrated by the report of the American consul at Cardiff in which the following is given:[1] "The tin-plate trade of South Wales has persistently gone from bad to worse during the last few months." In a manifesto appearing in the *Industrial World*, the official organ of the Tin-Plate Worker's Union, are several interesting statements that corroborate the opinion of the American consul. The one now given sets forth the condition of the tin-plate business in a dismal picture. "At the beginning of the week 144 out of our 512 mills were idle. This can be contrasted with the state of affairs before the McKinley tariff came into operation. In January, 1889, there existed 482 mills, 17 of which were idle. . . . The Welsh mills, with the comparatively few mills on the continent of Europe, are capable of fully meeting the requirements of the world for plates; that being so, every box of plates made in America means a box less in Wales."[2] Many other statements of like character have appeared in the various English newspapers. The writers are perfectly aware of the decline of the English industry and are fearful that the American market will be forever lost to them.[3] Mr. John H. Rogers, a large manufacturer of tin-plate in England, and president of the Tin-Plate Makers' Association, in a letter to the Tin-Plate Makers' Union, predicts that many of the men will lose their positions and that the coating part of the business will leave the country.[4] Preparations have already been made by some of the plants to change their business into that of galvanizing. All these facts point to a demoralization of the Welsh trade due evidently to a falling off in the American demand.

6. One final question remains for our consideration: What is

[1] Consular Reports, May, 1896, p. 67.

[2] *Ibid.*, p. 68.

[3] Consular Report, November, 1897, p. 323.

[4] Consular Reports, May, 1898.

the probability of the continued existence of the industry? The elements of success in the trade are the tariff, the cheapened production of steel, and the low price of labor. These three things have made it possible for the industry to gain a foothold in this country. The tariff seems to have given the incentive and at the same time to have protected the business from excessive competition in the beginning. The fact, as shown by previous tariffs, that such protection alone was unable to create the industry, gives additional importance to the other elements. If steel had not been low in price at the time wages were falling, it is doubtful whether the McKinley Act would have created the industry. In regard to the future, the indications are that steel will continue low in price for some time to come. The exports of steel made in the last two years certainly point to a decided advantage in this material over the English industry. So long as the progress in mining machinery and rolling mills continues, we may expect to retain this advantage. Wages, however, are certain to rise, and it is more than likely that two years will see them restored to the old level. Unless this advance can be offset by improved machinery, which is more than probable, there must be a slight rise in the price of tin-plate and with it some encouragement to foreign makers to enter our markets.

About the only market now left to the English makers is that of the Pacific coast. The freight rate on one hundred pounds from Wales to San Francisco is 18 cents; the rate from Pittsburg to the same city is 61¼ cents.[1] The price of English plates, duty paid, at the latter port would be $4.17. If the price for American plates is $3.45, then two makes are about the same, $4.17 and $4.16 per boxes of 108 lbs. delivered. Even this market is likely to be closed to England if the price falls below $3.45 per box.

		Per 100 Lbs
[1] South Wales	to Atlantic ports	12c.
" "	" Pacific "	18c.
" "	" Gulf "	15c.
Pittsburg	" Atlantic coast	15c.
"	" Pacific "	61¼c.
Indiana	" Gulf "	20c.
New York	" Chicago	20c.

—From Eng. For. Office Report, Mis. No. 426, p. 13.

The American tin-plate industry will undoubtedly continue in existence. At the present, combinations and trusts threaten to control the industry. A short-sighted policy on the part of the managers may lead to higher prices and renewed competition with English makers. Such an organization is more likely to cut expenses and hold the price just below the point of foreign competition, so that the danger from foreign rivalry is not great. The industry is not so dependent upon the tariff as might be supposed, and the actual possession of the market, accompanied by good product and sensible management, will make it possible to meet the foreign competition as the tariff is lowered.

The American consumer now pays about ninety-five cents more for American tin than the price of English plate delivered at New York. This is really a premium for the maintenance of the American industry. If in the course of ten or fifteen years our manufacturers can meet the English price, the cost, expense, and trouble in creating the industry have been justified. As it now stands three things may endanger the industry: (1) rise in cost of steel, (2) in wages, (3) and in block tin. If this rise should occur in the three cases at the same time, the industry would hardly stand under the blow. As has already been pointed out, steel is not likely to increase in price, while the output of the Banca mines will protect us in some degree from any change in the price of Welsh block tin. At the same time American ingenuity will undoubtedly increase the efficiency of labor so that the disadvantages now labored under may gradually disappear. Taken all in all, the development of this industry is a remarkable example of timely legislation. The conditions were present, the tariff permitted their utilization, but in no sense must the importance of the conditions be underestimated.

The Tin-Plate Combination

I

The excessive competition of the many tin-plate plants established under the hot-house influences of the tariff of 1890, in company with rising prices of materials, has brought about the

formation of a combination known as the American Tin-Plate Company. Three things — tariff, low price of steel, and low wages — fortunately meeting at the same time made possible the rapid growth of this industry. In 1890 there were two or three plants struggling under great difficulties, barely competing with foreign makers. The McKinley, Wilson, and Dingley bills restricted this competition to such an extent, and incited enterprise to such a degree, that 1898 saw forty-one plants engaged in the industry with every promise of prosperity.[1] The transformation, just spoken of, was almost marvellous. The tariff, checking foreign competition, made it possible for those engaged in the industry to construct their mills and at the same time secure the double advantage of cheap steel and low wages. The output increased rapidly from a few hundred thousand pounds to hundreds of millions of pounds,[2] while the great imports of early years fell rapidly to less than a third of what they had been in 1890. Meantime the English industry suffered greatly. The American market was the one great consumer of English tin. There had been some dissatisfaction with English methods and English manufacture, so that the American producers had no opposition to fight and overcome among the consumers of English tin in this country. In fact, the purchasers of the commodity seemed ready to welcome any movement likely to affect English prices.

The price during the period of English supply ranged above $5.00 per box IC 14 x 20 plates. Although the tariff added some $1.62 to the price of English tin-plate per box of 108 lbs., nevertheless so great was the influence of the loss of the American market that the price f.o.b. at Liverpool fell to about $2.40.[3] This in a way set a limit to the price of American tin-plate, so that the quotation in this country has remained below five dollars. Since 1893 the price was pushed, under the rivalry of the different tin-plate makers, lower and lower below this limit, until $2.70 was reached in December, 1898.[4] This was undoubtedly pretty near cost.

[1] *Yale Review*, VII, 302, November, 1898. The Tin-Plate Industry.

[2] *Ibid*, p. 313.

[3] Eng. Foreign Office Report, No. 426, p. 9.

[4] *Tin and Terne*, Jan. 26, 1898.

This movement from the comparatively high prices of 1893 steadily downwards to a point so near cost was not a healthy one. It was indicative of excessive output and competition. One-half of the forty-one plants could easily have supplied the market. The fall in price alone was not sufficient to cause the failure of any of the plants, although new factories were erected during the year, increasing the competition. The industry would only be permanently[1] endangered by (1) a rise in the price of steel, (2) a rise in wages, (3) an increase in the cost of pig tin, or (4) the repeal of the tariff. Any one of these, with the exception of the last, was hardly sufficient to cause the continued embarrassment of the tin-plate companies, but two working together were sure to make the conditions of manufacture exceedingly hard, while a movement upward in the case of the first three threatened the renewal of foreign competition and the possible extinction of the business. Two at least of the above-mentioned possibilities have taken place; tin and steel have both risen in the last year and, in the case of steel, the chances are that the price will range high for some time to come. Block tin is now hard to get and is rising in price. In regard to labor, there is considerable question, but undoubtedly the tendency is in the direction of higher payment. The Amalgamated Association has constantly insisted that such should be the case in the iron and steel industries, and the tin-plate makers will be compelled to follow the example set by the kindred industries.

At the opening of the year pig tin was selling for $13\frac{3}{4}$ cents per pound in New York.[2] In January, 1899, the quotation had advanced eleven points, the market showing great firmness with every indication of going still higher and possibly equalling the price of $37\frac{1}{2}$ cents of 1889. This increase added twenty-seven cents to the cost of producing a box of IC 14 x 20 tin-plates. During the same time the market price of steel billets rose two dollars per ton. By this change in the cost of material eleven cents more were added to the charge of making tin-plates. In a year's time the manufacturer found he was producing plates

[1] *Yale Review*, November, 1898, VII, p. 318.

[2] *Tin and Terne*, Jan. 26, 1898.

at an increased expense of thirty-eight cents per box, and the market price down to $2.70 at mill for first-class plates. The situation is indicated by the accompanying table:

WHOLESALE PRICE OF TIN-PLATE (BESSEMER STEEL IC 14 X 20, IN NEW YORK PER BOX OF 100 LBS.) AND OF STEEL BILLETS (PER LONG TON, AT PITTSBURG, PA.)[1]

1893	STEEL BILLETS	TIN-PLATES	1896	STEEL BILLETS	TIN-PLATES
July,	$21.50–22.00	$5.05	July,	$18.25–20.25	$3.47½
August,	21.00–21.25	5.00	August,	–20.25	3.50
September,	–20.50	4.85	September,	–20.50	3.50
October,	–18.50	5.00	October,	–20.25	3.50
November,	17.50–18.00	5.00	November,	–20.25	3.65
December,	17.00–17.50	4.90	December,	–20.25	3.70
1894			1897		
January,	–15.90	4.87½	January,	–16.00	3.75
February,	16.00–16.25	4.85	February,	–15.50	3.80
March,	–15.50	4.85	March,	18.00–20.00	3.75
April,	–15.75	4.80	April,	–15.25	3.60
May,	16.75–17.00	4.75	May,	–14.75	3.70
June,	19.00–19.50	4.75	June,	14.25–14.50	3.70
July,	–18.50	4.72½	July,	14.00–14.25	3.70
August,	17.00–17.25	4.72½	August,	–14.25	3.70
September,	–18.00	4.77½	September,	15.00–15.25	3.70
October,	16.75–17.00	3.85	October,	–16.50	3.70
November,	–15.45	3.75	November,	16.25–16.50	3.90
December,	15.25–15.50	3.65	December,	–15.00	3.70
1895			1898		
January,	15.00–15.25	3.60	January,	15.00–15.25	3.80
February,	15.00–15.25	3.57½	February,	–15.00	3.85
March,	15.00–15.25	3.50	March,	15.25–15.50	3.85
April,	15.25–15.60	3.50	April,	15.50–15.75	3.85
May,	15.50–15.75	3.52½	May,	15.00–15.25	3.85
June,	17.75–18.00	3.52½	June,	–15.00	3.85
July,	20.50–20.75	3.65	July,	–14.75	3.85
August,	21.50–22.00	3.75	August,	–14.75	3.85
September,	–	3.65	September,	–16.25	3.95
October,	24.00–24.25	3.65	October,	–16.00	3.95
November,	21.00–21.50	3.65	November,	15.50	3.95
December,	18.00–18.50	3.60	December,	15.75–16.00	3.95
1896			1899		
January,	16.00–16.25	3.60	January,	16.50–16.75	2.92½
February,	18.25–18.50	3.52½	February,	–17.25	3.25
March,	–17.00	3.45	March,	21.00–22.00	3.70
April,	–20.00	3.42½	April,	25.00–26.00	3.91
May,	–20.25	3.47½	May,	–26.50	3.97½
June,	–20.25	3.47½			

[1] Monthly Summary of Finance and Commerce of the United States, December, 1897, pp. 885, 889; April, 1899, pp. 2434, 2437, 2441, 2445. Quotations taken at the beginning of each month.

It is not difficult to understand why steel billets should increase in value. The great demand for rails and steel for bridges and buildings under the reviving industry of the year explains fairly well this rise, but pig tin does not come under the influence of American production. The probabilities are that the market in this material has been cornered. Such a feat would be by no means difficult. The output is comparatively small, and passes through but few hands. If such is the case, the next year will see an increased output and the correction of the present condition. In this relation *Tin and Terne*, commenting on the situation, says the advance is a most radical one, and it seems certain that if the tin-plate manufacturing business in the country had remained in control of the individual companies, many would have been forced to the wall in the effort to fill contracts.[1]

It will be seen from what has been already said that the tin-plate industry was in far from a healthy condition. Everything pointed to demoralization. It was very natural that, under these conditions, repeated attempts should be made to form a combination. The wasteful methods that had characterized the early industry had been largely corrected, and in their place had been substituted economies so sweeping that it was almost impossible for the companies to get to a lower cost basis without consolidation.[2]

II

Early in 1898 negotiations were begun by persons interested in the tin-plate industry to ascertain if it were possible to form a company that should control the plants of the country. A meeting of the most important manufacturers was held at Pittsburg in January of last year.[3] Many representatives of the different interests were there. An attempt was made to get options on the various plants engaged in this industry. A number of the concerns thinking the time opportune to place a high valuation on their properties did so, but in most instances,

[1] *Tin and Terne*, Jan. 26, 1899.
[2] *Ibid.*, Jan. 12, 1899.
[3] *Iron Age*, Jan. 20, 1898.

especially in those cases where plates had been sold below cost, the owners were willing to be a party to a reasonable agreement. The result of the meeting was undoubtedly a step toward further organization. Evidently there was a carefully arranged plan back of the whole movement which was to be carried out on well-determined lines. This conference was followed by a committee meeting in New York during the first week of February. Four of the tin-plate manufacturers present at Pittsburg had been appointed to confer with the jobbers in New York city. During the importing period the "Big Four," consisting of brokerage firms in the city just mentioned, dominated the business of tin-plate jobbing. The object of the committee was to deal with these firms, who were regarded as powerful factors in the business. It was expected that they would oppose consolidation, and it was therefore determined that firmness should be the tactics of the committee. The committee made the following proposition: that if the four merchant concerns wished to coöperate, they must furnish funds necessary to meet one-third of the expense of consolidation. To this proposition the merchants objected, but they were informed that the consolidation would go on even if they did not take advantage of the offer. It is quite evident, from the arrangements which have been made for the sale of tin-plates as well as the disappearance of these firms from the market, that the offer was not accepted. The attempt was to unite both mill owners and principal dealers, but in the event of failure to bring together the mill owners, at least. A great many in the trade were exceedingly sceptical in regard to the movement. So well, however, did the conditions in the market aid the promoters that 1899 saw the formation of the syndicate and the purchase of thirty-nine plants controlling 279 mills.

The final goal of the promoters of the syndicate (and it was constantly insisted that the movement was a syndicate movement rather than a combination) was to imitate the organization of the American Steel and Wire Company. This last concern completed its organization early in 1898, and furnished a practical example for the tin-plate promoters. A comparison of the two combinations is, therefore, more than usually interesting.

Comparison

AMERICAN STEEL AND WIRE CO.[1]	AMERICAN TIN-PLATE CO.[2]
Stock	
1. Capital stock of $90,000,000, of which $40,000,000 is 7 per cent cumulative preferred stock and $50,000,000 common stock.	1. Capital stock, $50,000,000, $20,000,000 preferred and $30,000,000 common stock. The preference shares bear 7 per cent interest cumulative.
Dividends	
2. Dividends upon preferred stock shall be cumulative. In case of dissolution or liquidation the holders of preferred stock are to be paid in full both the principal and accrued dividend charges before any amount is paid to the holders of common stock.	2 In the event of liquidation or dissolution of the corporation the holders of the aforesaid cumulative preference shares shall be paid the full amount with accrued dividends. After such payments the remaining assets shall be divided among the holders of the other shares.
Capital	
3. The amount of capital stock with which it will commence business is $250,000.	3. The amount of capital stock with which it will commence business is $10,000.
Object	
4. (*a*) To manufacture and trade in steel, iron and other metals; to make, purchase and sell manufactured articles made partly or wholly from metals of any kind and all like or kindred products; to acquire and dispose of rights to make and use the same; to make and purchase and sell such other products or merchandise as may be conveniently or advantageously used or sold in connection with said metals and business; and to apply for, purchase or otherwise acquire and hold, own, use, operate, sell, assign or otherwise dispose of patents, rights, and processes. (*b*) The corporation shall have power to *purchase, hold, transfer, mortgage, pledge or otherwise dispose of the shares of the capital stock of, or any bonds, securities or evidences of indebtedness created by any other corporation or corporations of this or any other state, and while owner of such stock may exercise all*	4. (*a*) To manufacture and trade in tin, terne, block plates, steel sheets, and all like or kindred products, to mine, manufacture, prepare for market, market and sell the same, and any articles or product in the manufacture or composition of which metal is a factor; including the acquisition by purchase, mining, manufacture or otherwise of all materials, supplies and other articles necessary or convenient for use in connection with and in carrying on the business herein mentioned, or any part thereof. (*b*) In addition to the general powers the company shall also have the following powers: To manufacture, deal, own, sell, transfer, etc., goods, wares and property of every description and to do mining of any kind. To also own and dispose of real estate in any part of the world to any amount To acquire good will and rights and property of any kind *and to undertake the whole or any part*

[1] *Tin and Terne*, Jan. 26, 1899.

[2] Charter of American Tin-Plate Co.

NOTE.—Both companies are chartered under the laws of New Jersey.

AMERICAN STEEL AND WIRE CO.

Object

rights, powers and privileges of ownership including right to vote. The corporation shall have the power to establish offices in this and other states and may hold or transfer any real or personal property in this and other countries.

Directors

5. Directors shall be divided into three classes, equal in number, in respect to the time for which they shall severally hold office. The first for three years, the second two years, third one year. Office shall be for three years thereafter.

With the assent in writing or pursuant to the vote of holders of two-thirds of the capital stock, the directors shall have power to sell, assign or transfer, convey or otherwise dispose of the property and assets of this corporation as the directors may see fit.

The power to make and alter the by-laws shall remain with the directors. The directors shall have power to hold their meetings wherever may be designated by them. The accounts of the corporation are only open to stockholders upon conditions determined by the directors.

AMERICAN TIN-PLATE CO.

Object

of the assets and liabilities of any person, firm, association or corporation, and to pay for the same in cash, stocks of this corporation, bonds or otherwise. To also apply for, hold, own, dispose of patents, processes, licenses and trade marks, etc.

To make contracts with any individual firm, association, corporation, and with the government of the United States, state or colony. To do all and everything necessary to promote the interests of shareholders whether manufacturing, mining or otherwise.

Directors

5. *Directors* shall be divided into five classes. The first class being elected for five years, the second, four years, etc, so that the term of office shall be five years thereafter. The board shall fill vacancies in the board. Shall have the power to make and alter by-laws.

With the assent in writing and pursuant to the vote of holders of two-thirds of all stock irrespective of class, directors shall have the power to sell, assign and transfer, convey or otherwise dispose of the property and assets of this corporation as the directors may see fit.

An executive committee consisting of five members shall have the power to conduct the business when the directors are not in session. Officers of the committee shall be a chairman, vice-president and a secretary. They shall be elected by all the stockholders. The term of office shall be coextensive with the office of director. Members of the committee shall not be subject to removal for any cause by the board of directors, and shall hold office until their successors are elected. No stockholder shall have the right to inspect any account, book, or document of the corporation except as conferred by statutes of New Jersey or authorized by the directors.

The thing that impresses the reader of the comparison made above is similarity of organization, the broad features of the charters, and the general and undetailed character of the provisions. In section four it will be noticed that the intention of the framers is to give the corporations the power of control over all properties bought in any manner, whether from individual, firm, or corporation, and that in the case of the American Steel Wire and Rod Co. the right to vote acquired by the purchase of such properties remains with the board of directors. There is nothing in the provisions of the two charters which would make it impossible for either one to incorporate the other and form one great concern. Whether the logic of combination will lead to such a result is difficult to say.

Let us turn now to some of the more salient features of the American Tin-Plate Company's charter. First, the stock. The amount of this is fifty millions of dollars, twenty millions of which is preferred and thirty millions common. It has been determined that two millions of each are to remain in the treasury, while but eighteen millions of each are to be issued, leaving ten millions for the promoters.[1] There is a further provision that for each subscription of one hundred dollars of preferred stock one hundred dollars of common stock is given to the subscriber.[2] On March 27 the preferred stock of this company was selling for 95 and the common was quoted at 42. This means that the promoters have received something over four millions for their work. The total capitalization of all the tin-plate firms in the United States was estimated, before the formation of the company, at between three and five millions of dollars.[3] Even granting that it was ten millions, which is undoubtedly too high an estimate, the excessive capitalization of the syndicate means watered stock on the face of it. If it is possible for the syndicate to carry such a load, there is always the danger of competition, failure to pay dividends, especially on the common stock, and as a consequence great losses to the innocent purchasers of common stock. The syndicate thus

[1] *Iron Age*, Dec. 10, 1898.
[2] *Bradstreet's*, Nov 26, 1898, p 766.
[3] *Yale Review*, November, 1898, VII, p. 314.

begins its business operations hampered by excessive obligations and immediate prospect of competition, unless effective means are taken to prevent it.

In the organization of this company a distinction is to be made between it and the usual trust. The provisions of trusteeship are altogether absent, so that the legal restrictions upon trusts may be avoided. This is true so far as the letter of the law is concerned, but in the actual working of the company the executive committee provided for by the charter is in almost every sense the equivalent of the trustees in a trust. This body is elected by the stockholders and the members of it cannot be removed by the board of directors. It undoubtedly goes without saying that this committee will control the business of the company. The stockholders have no right "to examine or inspect the accounts, books, or documents of the corporation, except as conferred by the statutes of New Jersey or authorized by the directors." This, of course, means just as absolute a control of the affairs of the company as though the organization were a trust in letter as well as in actual fact. It is also to be noticed that the usual freedom of the directors is made a prominent part of the charter. It is only by a two-thirds vote that the stockholders can order the sale, assignment, or transfer of any of the assets of the company and then only as the directors see fit. The holders of the stock of the local companies have exchanged it, or sold it, and then bought the general shares of the American Tin-Plate Company. The promoters of the combination do not give the owners of the different plants any option in the disposition of their stock; it is sell or shut up your works. The movement is, therefore, in reality a complete trust in all respects, except the one which gives to the holders of stock the right to vote on the disposition of the stock by the directors.

We now turn to the policy of the company.

III

In considering the policy of the syndicate the following points suggest themselves for treatment: (1) relation to the tin-

plate plants of the combination, (2) dividends, (3) attitude toward the trade, (4) machinery firms, (5) various economies, (6) wages. It is exceedingly difficult to get detailed information concerning the inner working of the combination, but sufficient is indicated here to show in a general way what the trend of the movement is.

1. At the present time a number of the plants have been closed down.[1] Among these are some of the largest and best equipped mills in the country. The company now owns every tin-plate plant in the United States making a product for the general trade. Just how long these establishments are to remain closed is impossible to say, but undoubtedly the company is trying to find out to just what extent it is necessary to operate the different plants to supply the demand. If it is discovered that all or nearly all are necessary, two lines of policy are open to the directors: first, to operate all the mills owned by the company; second, to close the more poorly equipped and badly situated mills and to increase the producing power of the better plants. It is more than likely that the second, or at least a modification of it, will be followed, as is indicated to some degree by the contracts of the syndicate with the equipment firms.

2. It is continually asserted that the American Tin-Plate Co. will[2] be able to pay dividends from the start not only on the preferred stock, but on the common stock as well. This dividend, it is said, will be declared on April 1 to at least 1½ per cent.[3] The company has only been in existence since December, 1898, and although large orders have undoubtedly been given to the company, nevertheless the prices of tin-plate have not advanced sufficiently to pay the increased cost of steel and tin in production[4] If this is so, it is not likely that any dividends will be paid on common stock for some time, although in some instances the combine bought the material on hand at the

[1] *Tin and Terne*, Feb. 23, 1899.

[2] *Ibid*, Feb. 9, 1899.

[3] Statement made in February, 1899

[4] This means on $46,000,000 of capital $1,420,000, including preferred dividends. Add to this organization expenses, operation and material, and the difficulty of such a course is at once apparent.

various mills at cost.[1] This will give a larger margin. There is, of course, the temptation constantly before such a concern to pay dividends out of capital stock in order to push up the quotation of common stock. But the whole attitude of the company seems to be that of a legitimate manufacturing enterprise rather than a speculative movement. Taken all in all, the company is not likely to force the payment of dividends before it earns them.

3. In relation to the trade, a radical change has been instituted. The company has laid down the principle that it will not have any dealings with brokers in tin-plate.[2] The idea upon which this policy is based is that with but one producing company of tin-plate there is no need of a broker. The company makes no quotation except on request and in carload lots. The territory is divided into two districts: the eastern section with headquarters at New York, and the western division with headquarters at Chicago. The Alleghany Mountains are the dividing line. Two men have been appointed as general agents over these divisions. The sales part of the business will be independent of the other parts, the management of the mills having no jurisdiction over the general agents.[3] The price of $3.00 has been fixed for carload lots of 100 lb. boxes of coke plates at the mill. Business involving less than a carload is turned over to the jobber nearest to the customer. All quotations will be f. o. b., New York, Chicago, or destination, so that there will probably be some advance on the quotation given above. The increasing price of raw material will also change from time to time the quotation of $3.00 f. o. b. at mills.[4]

4. Arrangements have been made with nearly every firm in the land engaged in manufacturing machinery for tin-plate plants, to sell their entire product to the American Tin-Plate Co. Any combination always brings a lot of promoters into existence who expect to build plants and force the combination to buy them at a fancy price. This the new company expects to forestall by arranging with the equipment firms to take their entire output. It is said that an agreement

[1] *Tin and Terne*, Feb. 9, 1899.
[2] *Ibid.*, Jan. 26, 1899.
[3] *Iron Age*, Jan. 19, 1899.
[4] *Tin and Terne*, Feb. 9, 1899.

has been made between the two parties for five years ending January 1, 1904.[1] Just what and how much this product is to be is determined by the tin-plate company, and the managing committee distribute the machinery secured under this agreement among the different plants as it sees fit. The prices paid for machinery are lower than if equipments were bought in the open market. There will also be an attempt made to get the machinery firms to specialize, so that each will be a producer of a certain kind of machinery. It will thus be all but impossible to start a new mill to produce such machinery. If, however, there is any special demand because of the attitude of the company, it may be assumed that machine companies in other lines will enter the field as makers of tin-plate equipment. The whole arrangement, nevertheless, is indicative of the shrewd and not to be defeated attitude of this new combination.

5. In addition to the savings already pointed out the company has instituted various other economies of some importance. It is usually the custom upon the organization of a big concern like the tin-plate combination to give enormous salaries. This the directors and promoters have absolutely refused to do. The compensation will be fair, but not high. The *Tin and Terne* says in regard to this point, "We have it on good authority that the salaries paid the officers of the new concern will be very low."[2] The number of officers will also be cut down to the smallest number possible.

The company, in quoting prices f. o. b. from New York and Chicago, and shipping to the purchaser from the nearest mill, will be in a position to save some very considerable amounts in the course of a year on freight rates. Whether it will secure any concessions from the railroads in freight rates is not known. Until the rate between Pittsburg and Chicago is very considerably reduced, the company will have to face the English competition on the Pacific coast. The rate on one hundred pounds from Wales to San Francisco is 18 cents, from Pittsburg to the same city $61\frac{1}{4}$ cents.[3] The English tin-plates were

[1] *Tin and Terne*, Feb. 9, 1899. [2] *Ibid.*, Jan. 12, 1899.
[3] *Yale Review*, November, 1898, VII, p. 317.

selling in December at $2 30 per box of 100 lbs. at Liverpool.[1] It is therefore possible for the English companies to deliver plates at San Francisco, tariff paid, for $4.10. The present cost to the tin-plate company is some three or four cents above this when the price quoted is $3.50. This means that English and American plates will be somewhat on an equality in their competition on the Pacific coast. Undoubtedly, if there is a sufficient incentive, the railroads will reduce the rate, and make it possible to go under the English price.

The company is too new to show how much of a saving may be effected by the new management. Probably greater uniformity and closer attention to cutting and waste will produce some economies.

6. The question of wages is one of the difficult things with which the new company has to deal. The tendency is in the direction of a considerable increase in wages in all the steel industries. The advance in the selling price of tin-plate has stimulated the officers of the Amalgamated Association to ask for a higher scale of wages. "Previous to July 1, 1896, the base wages were to be paid as long as the selling price of tin-plate was not more than one-fourth the selling price of a ton of steel billets; since then the ratio has been one-fifth."[2] The company is in a peculiar position in the matter of wages. According to the agreement above, the company must pay higher wages if the ratio between steel and tin increased. This has changed. Tin-plates have increased in price on account of the added cost of pig tin, and because of this addition the market quotation has risen and the company must pay more wages. "With the rapidly advancing prices of sheet iron, there is a possibility that an advance may be called for in the wages of the sheet mill men also. The Amalgamated Association places an arbitrary limit upon the output, so that the increased machinery equipment does not bring a proportional benefit to the manufacturer.[3] The company is, therefore, encountering high prices in raw material (steel and pig tin) and in wages." It is questionable whether the economies spoken of above will

[1] Monthly Summary of Commerce and Finance, December, 1898, p. 1413.
[2] *Tin and Terne*, Feb. 23, 1899. [3] *Iron Age*, March 31, 1898, p. 16.

any more than make up for these extra expenses. The economic strength of the company will enable it to meet these difficulties without any great trouble.

IV

The tin-plate combination is an arbitrary but natural attempt to raise the price of that product. It is interesting to note to just what extent the combination is due to the tariff. In the first section of our study reference was made to the repeal of the tariff as one of the possible ways of injuring the industry. Without the protection now afforded to tin-plate through the Dingley Bill it would be impossible for the industry to exist. The tariff, however, did not directly create the combination. Under the protection afforded since 1890 many plants came into existence, competing with one another until the price was unduly lowered. Then came efforts to organize a great syndicate, which were successful. In consequence of that organization, the price of tin-plate has been increased, and a monopoly over the production of it secured through the policy of the company in relation to dealers and machine makers. The consumer is thus forced to pay for not only the maintenance of the industry, but also the profits of the company. The English makers are shut out of the market and the combination thus completely controls the production of the commodity inside of the country. So long as the tariff remains at a protective figure, it is likely that the syndicate will be able to stop any effort to renew the competition.

Another factor bids well to enter the problem which has probably been overlooked in the calculations of the syndicate managers. That is the repeal of the tariff duties. In the last few months several of the more prominent papers representing the political party that established the tariff on tin-plate have commented editorially on the necessity of that party taking up the question of monopolies.[1] Severally these papers have reached a common solution. Their editors have come to regard the tariff as responsible for trusts and, therefore, the

[1] *Philadelphia Ledger*, *Chicago Times-Herald*, *St. Paul Pioneer Press*.

repeal of such legislation the direct and effective way of dealing with them. It is not necessary to consider any arguments for or against the above supposition. But any such attitude to the extent of legislation threatens the existence both of the tin-plate syndicate and the industry. It would be impossible for the American syndicate to withstand the renewal of English imports. Two movements might result from such a policy on the part of Congress: first, to break the syndicate into many parts, the individual companies claiming that they were no longer a party to the monopoly agreement, but were still in need of the protection; second, for the present company to unite with the English firms in an effort to form an international combination. This would be the more natural step to take, but at the same time the more difficult one to accomplish. The popular demand and the hostile attitude of the people toward large capitalistic concerns will undoubtedly cause the party to very seriously consider the movement spoken of above. The possibility of such an attitude will impress itself on all thinking men.

On the other hand, another movement, other than political, can be seen in the iron and steel industries. Within the last two years a number of concerns have entered combinations so that to-day instead of there being many companies engaged in allied lines of industry, there are several combinations corresponding to the several lines of production. A very large part of the iron and steel product is controlled by seven corporations.[1] A reference to the respective charters of the American Tin-Plate and American Steel and Wire companies, is sufficient to indicate that the union of combinations with combinations is by no means impossible. There is one limitation upon such a movement and that is the inability of men to manage a concern economically that has a capital and output beyond a certain amount. Until that point is reached, combination will probably continue, and it is possible that we may see an attempt to unite all of the iron and steel industries

[1] American Steel and Wire Co., American Tin-Plate Co., the Granite Ware Co., the Carnegie Co., Union Chain and Steel Co., the Illinois Steel Co. and Mesaba Range Mining Co.

under one management. As has already been pointed out, there is nothing in the charters of the two concerns compared in the second section of this article to prevent union. The provisions are so wide that the manufacture of steel wires and rods could be carried on by the tin-plate company or the production of tin-plate by the steel wire and rod company. It would be natural that the two should unite, or the entire steel industry might possibly come under the control of one gigantic combination.

The industry of our study thus stands in two dangers: first, of possibly placing prices so high that it will be impossible to maintain them, leading to a virtual revolt on the part of consumers; and second, the political movement culminating in the possible withdrawal of the tariff. If the consumers of tin become dissatisfied with the attitude of the company in the matter of prices, the political movement may be reenforced by their opposition to the combination

The American Tin-Plate Company has existed less than six months, so that the developments possible to the future are necessarily conjectural. Strong as the company is in its organization, it is particularly vulnerable from the political movement mentioned above.

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XIV

THE NORTHERN SECURITIES COMPANY[1]

MR. JUSTICE HARLAN announced the affirmance of the decree of the circuit court, and delivered the following opinion:

This suit was brought by the United States against the Northern Securities Company, a corporation of New Jersey; the Great Northern Railway Company, a corporation of Minnesota; the Northern Pacific Railway Company, a corporation of Wisconsin; James J. Hill, a citizen of Minnesota; and others.

Its general object was to enforce, as against the defendants, the provisions of the statute of July 2, 1890, commonly known as the Anti-Trust Act, and entitled "An Act to Protect Trade and Commerce Against Unlawful Restraints and Monopolies." 26 Stat. at L., 209, chap. 647, U. S. Comp. Stat. 1901, page 3200. By the decree below the United States was given substantially the relief asked by it in the bill.

As the act is not very long, and as the determination of the particular questions arising in this case may require a consideration of the scope and meaning of most of its provisions, it is here given in full:

§ 1. Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several states, or with foreign nations, is hereby declared to be illegal. Every person who shall make any such contract, or engage in any such com-

[1] Abridged from the text of the decision. Supreme Court of the United States, No. 277, October Term, 1903, *Northern Securities Company, etc.*, v. *The United States*, March 14, 1903.

An excellent history of the case is given in outline by Professor B H Meyer, in the *Railway Age*, March 18, 1903, to be published in more extended monographic form shortly. A bibliography of the subject is also appended to A List of Books relating to Railroads, published by the Library of Congress, 1904. — ED.

bination or conspiracy, shall be deemed guilty of a misdemeanor, and, on conviction thereof, shall be punished by fine not exceeding five thousand dollars, or by imprisonment not exceeding one year, or by both said punishments, in the discretion of the court.

§ 2. Every person who shall monopolize, or attempt to monopolize, or combine or conspire with any other person or persons to monopolize, any part of the trade or commerce among the several states, or with foreign nations, shall be deemed guilty of a misdemeanor, and, on conviction thereof, shall be punished by fine not exceeding five thousand dollars, or by imprisonment not exceeding one year, or by both said punishments, in the discretion of the court.

§ 3. Every contract, combination in form of trust or otherwise, or conspiracy, in restraint of trade or commerce in any territory of the United States or of the District of Columbia, or in restraint of trade or commerce between any such territory and another, or between any such territory or territories and any state or states or the District of Columbia, or with foreign nations, or between the District of Columbia, and any state or states or foreign nations, is hereby declared illegal. Every person who shall make any such contract or engage in any such combination or conspiracy shall be deemed guilty of a misdemeanor, and, on conviction thereof, shall be punished by fine not exceeding five thousand dollars, or by imprisonment not exceeding one year, or by both said punishments, in the discretion of the court.

§ 4. The several circuit courts of the United States are hereby invested with jurisdiction to prevent and restrain violations of this act; and it shall be the duty of the several district attorneys of the United States, in their respective districts, under the direction of the Attorney-General, to institute proceedings in equity to prevent and restrain such violations. Such proceedings may be by way of petition setting forth the case and praying that such violation shall be enjoined or otherwise prohibited. When the parties complained of shall have been duly notified of such petition the court shall proceed, as soon as may be, to the hearing and determination of the case; and, pending such petition, and before final decree, the court may at any time make such temporary restraining order or prohibition as shall be deemed just in the premises.

§ 5. Whenever it shall appear to the court before which any proceeding under section four of this act may be pending, that the ends of justice require that other parties should be brought before the court, the court may cause them to be summoned, whether they reside in the district in which the court is held or not; and subpœnas to that end may be served in any district by the marshal thereof.

§ 6. Any property owned under any contract or by any combination, or pursuant to any conspiracy (and being the subject thereof) mentioned in section one of this act, and being in the course of transportation from one state to another, or to a foreign country, shall be forfeited to the United States, and may be seized and condemned by like proceedings as those provided by law for the forfeiture, seizure, and condemnation of property imported into the United States contrary to law.

§ 7. Any person who shall be injured in his business or property by any other person or corporation by reason of anything forbidden or declared to be unlawful by this act may sue therefor in any circuit court of the United States in the district in which the defendant resides or is found, without respect to the amount in controversy, and shall recover threefold the damages by him sustained, and the costs of suit, including a reasonable attorney's fee.

§ 8. That the word "person" or "persons," wherever used in this act, shall be deemed to include corporations and associations existing under or authorized by the laws of either the United States, the laws of any of the territories, the laws of any state, or the laws of any foreign country.

Is the case as presented by the pleadings and the evidence one of a combination or a conspiracy in restraint of trade or commerce among the states, or with foreign states? Is it one in which the defendants are properly chargeable with monopolizing or attempting to monopolize any part of such trade or commerce? Let us see what are the facts disclosed by the record.

The Great Northern Railway Company and the Northern Pacific Railway Company owned, controlled and operated separate lines of railway, — the former road extending from Superior, and from Duluth and St. Paul, to Everett, Seattle and Portland, with a branch line to Helena; the latter extending from Ashland, and from Duluth and St. Paul, to Helena, Spokane, Seattle, Tacoma and Portland. The two lines, main and branches, about 9000 miles in length, were and are parallel and competing lines across the continent through the northern tier of states between the Great Lakes and the Pacific, and the two companies were engaged in active competition for freight and passenger traffic, each road connecting at its respective terminals with lines of railway, or with lake and river steamers, or with sea-going vessels.

Prior to 1893 the Northern Pacific system was owned or controlled and operated by the Northern Pacific Railroad Company, a corporation organized under certain acts and resolutions of Congress. That company becoming insolvent, its road and property passed into the hands of receivers appointed by courts of the United States. In advance of foreclosure and sale a majority of its bondholders made an arrangement with the Great Northern Railway Company for a virtual consolidation of the two systems, and for giving the practical control of the Northern Pacific to the Great Northern. That was the arrangement declared in *Pearsall* v. *Great Northern R. Co.* 161 U. S., 646, 40 L. ed., 838, 16 Sup. Ct. Rep., 705, to be illegal under the statutes of Minnesota which forbade any railroad corporation, or the purchasers or managers of any corporation, to consolidate the stock, property or franchises of such corporation, or to lease or purchase the works or franchises of, or in any way control, other railroad corporations owning or having under their control parallel or competing lines. Minn. Gen. Laws, 1874, chap. 29, 1881, chap. 109.

Early in 1901 the Great Northern and Northern Pacific Railway Companies, having in view the ultimate placing of their two systems under a common control, united in the purchase of the capital stock of the Chicago, Burlington & Quincy Railway Company, giving in payment, upon an agreed basis of exchange, the joint bonds of the Great Northern and Northern Pacific Railway Companies, payable in twenty years from date, with interest at 4 per cent per annum. In this manner the two purchasing companies became the owners of $107,000,000 of the $112,000,000 total capital stock of the Chicago, Burlington and Quincy Railway Company, whose lines aggregated about 8000 miles, and extended from St. Paul to Chicago, and from St. Paul and Chicago to Quincy, Burlington, Des Moines, St. Louis, Kansas City, St. Joseph, Omaha, Lincoln, Denver, Cheyenne and Billings, where it connected with the Northern Pacific Railroad. By this purchase of stock the Great Northern and Northern Pacific acquired full control of the Chicago, Burlington & Quincy main line and branches.

Prior to November 13, 1901, defendant Hill and associate

stockholders of the Great Northern Railway Company, and defendant Morgan and associate stockholders of the Northern Pacific Railway Company, entered into a combination to form, under the laws of New Jersey, a *holding* corporation, to be called the Northern Securities Company, with a capital stock of $400,000,000, and to which company, in exchange for its own capital stock upon a certain basis and at a certain rate, was to be turned over the capital stock, or a controlling interest in the capital stock, of each of the constituent railway companies, with power in the holding corporation to vote such stock and in all respects to act as the owner thereof, and to do whatever it might deem necessary in aid of such railway companies or to enhance the value of their stocks. In this manner the interests of individual stockholders in the property and franchises of the two independent and competing railway companies were to be converted into an interest in the property and franchises of the holding corporation. Thus, "by making the stockholders of each system jointly interested in both systems, and by practically pooling the earnings of both for the benefit of the former stockholders of each, and by vesting the selection of the directors and officers of each system in a common body, to wit, the holding corporation, with not only the power, but the duty, to pursue a policy which would promote the interests, not of one system at the expense of the other, but of both at the expense of the public, all inducement for competition between the two systems was to be removed, a virtual consolidation effected, and a monopoly of the interstate and foreign commerce formerly carried on by the two systems as independent competitors established."

In pursuance of this combination, and to effect its objects, the defendant, the Northern Securities Company, was organized November 13, 1901, under the laws of New Jersey.

Its certificate of incorporation stated that the objects for which the company was formed were:

1. To acquire by purchase, subscription or otherwise, and to hold as investment, any bonds or other securities or evidences of indebtedness, or any shares of capital stock created or issued by any other corpo-

ration or corporations, association or associations, of the state of New Jersey, or of any other state, territory or country.

2. To purchase, hold, sell, assign, transfer, mortgage, pledge or otherwise dispose of any bonds or other securities or evidences of indebtedness created or issued by any other corporation or corporations, association or associations, of the state of New Jersey, or of any other state, territory or country, and while owner thereof to exercise all the rights, powers and privileges of ownership.

3. To purchase, hold, sell, assign, transfer, mortgage, pledge or otherwise dispose of shares of the capital stock of any other corporation or corporations, association or associations, of the state of New Jersey, or of any other state, territory or country, and while owner of such stock to exercise all the rights, powers and privileges of ownership, including the right to vote thereon.

4. To aid in any manner any corporation or association of which any bonds or other securities or evidences of indebtedness or stock are held by the corporation, and to do any acts or things designed to protect, preserve, improve or enhance the value of any such bonds or other securities or evidences of indebtedness or stock.

5. To acquire, own and hold such real and personal property as may be necessary or convenient for the transaction of its business.

It was declared in the certificate that the business or purpose of the corporation was from time to time to do any one or more of such acts and things, and that the corporation should have power to conduct its business in other states and in foreign countries, and to have one or more offices, and hold, purchase, mortgage and convey real and personal property out of New Jersey.

The total authorized capital stock of the corporation was fixed at $400,000,000, divided into 4,000,000 shares of the par value of $100 each. The amount of the capital stock with which the corporation should commence business was fixed at $30,000. The duration of the corporation was to be perpetual.

This charter having been obtained, Hill and his associate stockholders of the Great Northern Railway Company, and Morgan and associate stockholders of the Northern Pacific Railway Company, assigned to the Securities company a controlling amount of the capital stock of the respective constituent companies upon an agreed basis of exchange of the capital stock of

the Securities company for each share of the capital stock of the other companies.

In further pursuance of the combination, the Securities company acquired additional stock of the defendant railway companies, issuing in lieu thereof its own stock upon the above basis, and, at the time of the bringing of this suit, held, as owner and proprietor, substantially all the capital stock of the Northern Pacific Railway Company, and, it is alleged, a controlling interest in the stock of the Great Northern Railway Company, "and is voting the same and is collecting the dividends thereon, and in all respects is acting as the owner thereof, in the organization, management and operation of said railway companies and in the receipt and control of their earnings."

No consideration whatever, the bill alleges, has existed or will exist, for the transfer of the stock of the defendant railway companies to the Northern Securities Company, other than the issue of the stock of the latter company for the purpose, after the manner, and upon the basis stated.

The Securities company, the bill also alleges, was not organized in good faith to purchase and pay for the stocks of the Great Northern and Northern Pacific Railway Companies, but solely "to incorporate the pooling of the stocks of said companies," and carry into effect the above combination; that it is a mere depositary, custodian, holder or trustee of the stocks of the Great Northern and Northern Pacific Railway Companies; that its shares of stock are but beneficial certificates against said railroad stocks to designate the interest of the holders in the pool; that it does not have and never had any capital to warrant such an operation; that its subscribed capital was but $30,000, and its authorized capital stock of $400,000,000 was just sufficient, when all issued, to represent and cover the exchange value of substantially the entire stock of the Great Northern and Northern Pacific Railway Companies, upon the basis and at the rate agreed upon, which was about $122,000,000 in excess of the combined capital stock of the two railway companies taken at par; and that, unless prevented, the Securities company would acquire, as owner and proprietor, substantially all the capital stock of the Great Northern and Northern Pacific Railway Com-

panies, issuing in lieu thereof its own capital stock to the full extent of its authorized issue, of which, upon the agreed basis of exchange, the former stockholders of the Great Northern Railway Company have received or would receive and hold about 55 per cent, the balance going to the former stockholders of the Northern Pacific Railway Company.

The government charges that if the combination was held not to be in violation of the act of Congress, then all efforts of the national government to preserve to the people the benefits of free competition among carriers engaged in interstate commerce will be wholly unavailing, and all transcontinental lines, indeed, the entire railway systems of the country, may be absorbed, merged and consolidated, thus placing the public at the absolute mercy of the holding corporation.

The several defendants denied all the allegations of the bill imputing to them a purpose to evade the provisions of the act of Congress, or to form a combination or conspiracy having for its object either to restrain or to monopolize commerce or trade among the states or with foreign nations. They denied that any combination or conspiracy was formed in violation of the act.

In our judgment, the evidence fully sustains the material allegations of the bill, and shows a violation of the act of Congress, in so far as it declares illegal every combination or conspiracy in restraint of commerce among the several states and with foreign nations, and forbids attempts to monopolize such commerce or any part of it.

Summarizing the principal facts, it is indisputable upon this record that under the leadership of the defendants Hill and Morgan, the stockholders of the Great Northern and Northern Pacific Railway corporations, having competing and substantially parallel lines from the Great Lakes and the Mississippi River to the Pacific Ocean at Puget Sound, combined and conceived the scheme of organizing a corporation under the laws of New Jersey which should *hold* the shares of the stock of the constituent companies; such shareholders, in lieu of their shares in those companies, to receive, upon an agreed basis of value, shares in the holding corporation; that pursuant to such combination the Northern Securities Company was organized as the holding cor-

poration through which the scheme should be executed; and under that scheme such holding corporation has become the holder — more properly speaking, the custodian — of more than nine-tenths of the stock of the Northern Pacific, and more than three-fourths of the stock of the Great Northern, the stockholders of the companies who delivered their stock receiving upon the agreed basis shares of stock in the holding corporation. The stockholders of these two competing companies disappeared, as such, for the moment, but immediately reappeared as stockholders of the holding company, which was thereafter to guard the interests of both sets of stockholders as a unit, and to manage, or cause to be managed, both lines of railroad as if held *in one ownership*. Necessarily by this combination or arrangement the holding company in the fullest sense dominates the situation in the interest of those who were stockholders of the constituent companies; as much so, for every practical purpose, as if it had been itself a railroad corporation which had built, owned and operated both lines for the exclusive benefit of its stockholders. Necessarily, also, the constituent companies ceased, under such a combination, to be in active competition for trade and commerce along their respective lines, and have become, practically, one powerful consolidated corporation, by the name of a holding corporation, the principal, if not the sole, object for the formation of which was to carry out the purpose of the original combination, under which competition between the constituent companies would cease. Those who were stockholders of the Great Northern and Northern Pacific and became stockholders in the holding company are now interested in preventing all competition between the two lines, and, as owners of stock or of certificates of stock in the holding company, they will see to it that no competition is tolerated. They will take care that no persons are chosen directors of the holding company who will permit competition between the constituent companies. The result of the combination is that all the earnings of the constituent companies make a common fund in the hands of the Northern Securities Company, to be distributed, not upon the basis of the earnings of the respective constituent companies, each acting exclusively in its own interests, but upon the basis of the certifi-

cates of stock issued by the holding company. No scheme or device could more certainly come within the words of the act, — "combination in the form of a trust or otherwise . . . in restraint of commerce among the several states or with foreign nations," — or could more effectively and certainly suppress free competition between the constituent companies. This combination is, within the meaning of the act, a "trust"; but if not, it is a *combination in restraint of interstate and international commerce;* and that is enough to bring it under the condemnation of the act. The mere existence of such a combination, and the power acquired by the holding company as its trustee, constitute a menace to, and a restraint upon, that freedom of commerce which Congress intended to recognize and protect, and which the public is entitled to have protected. If such combination be not destroyed, all the advantages that would naturally come to the public under the operation of the general laws of competition, as between the Great Northern and Northern Pacific Railway Companies, will be lost, and the entire commerce of the immense territory in the northern part of the United States between the Great Lakes and the Pacific at Puget Sound will be at the mercy of a single holding corporation, organized in a state distant from the people of that territory.

The circuit court was undoubtedly right when it said — all the judges of that court concurring — that the combination referred to "led inevitably to the following results: first, it placed the control of the two roads in the hands of a single person, to wit, the Securities Company, by virtue of its ownership of a large majority of the stock of both companies; second, it destroys every motive for competition between two roads engaged in interstate traffic, which were natural competitors for business, by pooling the earnings of the two roads for the common benefit of the stockholders of both companies." 120 Fed., 721, 724.

Such being the case made by the record, what are the principles that must control the decision of the present case? Do former adjudications determine the controlling questions raised by the pleadings and proofs?

The contention of the government is that, if regard be had to former adjudications, the present case must be determined in its

favor. That view is contested and the defendants insist that a decision in their favor will not be inconsistent with anything heretofore decided and would be in harmony with the act of Congress.

Is the act to be construed as forbidding every combination or conspiracy in restraint of trade or commerce among the states or with foreign nations? Or, does it embrace only such restraints as are unreasonable in their nature? Is the motive with which a forbidden combination or conspiracy was formed at all material when it appears that the necessary tendency of the particular combination or conspiracy in question is to restrict or suppress free competition between competing railroads engaged in commerce among the states? Does the act of Congress prescribe, as a *rule* for *interstate* or *international* commerce, that the operation of the natural laws of competition between those engaged in *such* commerce shall not be restricted or interfered with by any contract, combination or conspiracy? How far may Congress go in regulating the affairs or conduct of state corporations engaged as carriers in commerce among the states or of state corporations which, although not directly engaged themselves in *such* commerce, yet have control of the business of interstate carriers? If state corporations, or their stockholders, are found to be parties to a combination in the form of a trust or otherwise, which restrains interstate or international commerce, may they not be compelled to respect any rule for such commerce that may be lawfully prescribed by Congress?

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We will not encumber this opinion by extended extracts from the former opinions of this court. It is sufficient to say that from the decisions in the above cases certain propositions are plainly deducible and embrace the present case. Those propositions are:

That although the act of Congress known as the Anti-Trust Act has no reference to the mere manufacture or production of articles or commodities within the limits of the several states, it does embrace and declare to be illegal every contract, combination or conspiracy, in whatever form, of whatever nature, and

whoever may be parties to it, which directly or necessarily operates *in restraint* of trade or commerce *among the several states or with foreign nations;*

That the act is not limited to restraints of interstate and international trade or commerce that are unreasonable in their nature, but embraces *all* direct *restraints* imposed by any combination, conspiracy or monopoly upon such trade or commerce;

That railroad carriers engaged in interstate or international trade or commerce are embraced by the act;

That combinations, even among *private* manufacturers or dealers, whereby *interstate or international commerce* is restrained, are equally embraced by the act;

That Congress has the power to establish *rules* by which *interstate and international* commerce shall be governed, and, by the Anti-Trust Act, has prescribed the rule of free competition among those engaged in such commerce;

That *every* combination or conspiracy which would extinguish competition between otherwise competing railroads engaged in *interstate trade or commerce*, and which would *in that way* restrain *such* trade or commerce, is made illegal by the act;

That the natural effect of competition is to increase commerce, and an agreement whose direct effect is to prevent this play of competition restrains instead of promoting trade and commerce;

That to vitiate a combination such as the act of Congress condemns, it need not be shown that the combination, in fact, results or will result, in a total suppression of trade or in a complete monopoly, but it is only essential to show that, by its necessary operation, it tends to restrain interstate or international trade or commerce or tends to create a monopoly in such trade or commerce and to deprive the public of the advantages that flow from free competition;

That the constitutional guaranty of liberty of contract does not prevent Congress from prescribing the rule of free competition for those engaged in *interstate and international* commerce; and,

That under its power to regulate commerce among the several states and with foreign nations, Congress had authority to enact the statute in question.

No one, we assume, will deny that these propositions were distinctly announced in the former decisions of this court. They cannot be ignored or their effect avoided by the intimation that the court indulged in *obiter dicta.* What was said in those cases was within the limits of the issues made by the parties. In our opinion, the recognition of the principles announced in former cases must, under the conceded facts, lead to an affirmance of the decree below, unless the special objections, or some of them, which have been made to the application of the act of Congress to the present case, are of a substantial character. We will now consider those objections.

Underlying the argument in behalf of the defendants is the idea that, as the Northern Securities Company is a state corporation, and as its acquisition of the stock of the Great Northern and Northern Pacific Railway Companies is not inconsistent with the powers conferred by its charter, the enforcement of the act of Congress, as against those corporations, will be an unauthorized interference by the national government with the internal commerce of the states creating those corporations. This suggestion does not at all impress us. There is no reason to suppose that Congress had any purpose to interfere with the internal affairs of the states, nor, in our opinion, is there any ground whatever for the contention that the Anti-Trust Act regulates their domestic commerce. By its very terms the act regulates only commerce among the states and with foreign states. Viewed in that light, the act, if within the powers of Congress, must be respected; for, by the explicit words of the Constitution, that instrument and the laws enacted by Congress in pursuance of its provisions, are the supreme law of the land, "anything in the constitution or laws of any state to the contrary notwithstanding,"—supreme over the states, over the courts and even over the people of the United States,—the source of all power under our governmental system in respect of the objects for which the national government was ordained. An act of Congress constitutionally passed under its power to regulate commerce among the states and with foreign nations is binding upon all; as much so as if it were embodied, in terms, in the Constitution itself. Every judicial officer, whether of a national or a state court, is

under the obligations of an oath so to regard a lawful enactment of Congress. Not even a state, still less one of its artificial creatures, can stand in the way of its enforcement. If it were otherwise, the government and its laws might be prostrated at the feet of local authority. *Cohen* v. *Virginia*, 6 Wheat., 264, 385, 414, 5 L. ed., 257, 286, 293. These views have been often expressed by this court.

It is said that whatever may be the power of a state over such subjects, Congress cannot forbid single individuals from disposing of their stock in a state corporation, even if such corporation be engaged in interstate and international commerce; that the holding or purchase by a state corporation, or the purchase by individuals, of the stock of another corporation, for whatever purpose, are matters in respect of which Congress has no authority under the Constitution; that, so far as the power of Congress is concerned, citizens, or state corporations, may dispose of their property and invest their money in any way they choose; and that in regard to all such matters, citizens and state corporations are subject, if to any authority, only to the lawful authority of the state in which such citizens reside or under whose laws such corporations are organized. It is unnecessary in this case to consider such abstract, general questions. The court need not now concern itself with them. They are not here to be examined and determined, and may well be left for consideration in some case necessarily involving their determination.

In this connection, it is suggested that the contention of the government is that the acquisition and *ownership* of stock in a state railroad corporation is itself interstate commerce if that corporation be engaged in interstate commerce. This suggestion is made in different ways; sometimes in express words, at other times by implication. For instance, it is said that the question here is whether the power of Congress over interstate commerce extends to the regulation of the ownership of the stock in state railroad companies, by reason of their being engaged in such commerce. Again, it is said that the only issue in this case is whether the Northern Securities Company can acquire and hold stock in other state corporations. Still further,

it is asked, generally, whether the organization or ownership of railroads is not under the control of the states under whose laws they came into existence? Such statements as to the issues in this case are, we think, wholly unwarranted, and are very wide of the mark; it is the setting up of mere men of straw to be easily stricken down. We do not understand that the government makes any such contentions or takes any such positions as those statements imply. It does not contend that Congress may control the mere acquisition or the mere ownership of stock in a state corporation engaged in interstate commerce. Nor does it contend that Congress can control the organization of state corporations authorized by their charters to engage in interstate and international commerce. But it does contend that Congress may protect the freedom of interstate commerce by any means that are appropriate and that are lawful, and not prohibited by the Constitution. It does contend that no state corporation can stand in the way of the enforcement of the national will, legally expressed. What the government particularly complains of — indeed, all that it complains of here — is the existence of a combination among the stockholders of competing railroad companies which, in violation of the act of Congress, restrains interstate and international commerce through the agency of a common corporate trustee, designated to act for both companies in repressing free competition between them. Independently of any question of the mere ownership of stock or of the organization of a state corporation, can it in reason be said that such a combination is not embraced by the very terms of the Anti-Trust Act? May not Congress declare that *combination* to be illegal? If Congress legislates for the protection of the public, may it not proceed on the ground that wrongs, when effected by a powerful combination, are more dangerous and require more stringent supervision than when they are to be effected by a single person? *Callan* v. *Wilson*, 127 U. S., 540, 556, 32 L. ed., 223, 228, 8 Sup. Ct. Rep., 1301. How far may the courts go in order to give effect to the act of Congress, and remedy the evils it was designed by that act to suppress? These are confessedly questions of great moment, and they will now be considered.

By the express words of the Constitution, Congress has power to "regulate commerce with foreign nations and among the several states, and with the Indian tribes." In view of the numerous decisions of this court there ought not, at this day, to be any doubt as to the general scope of such power.

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As late as the case of *Re Debs*, 158 U. S., 564, 582, 39 L. ed., 1092, 1101, 15 Sup. Ct. Rep., 900, 905, this court, every member of it concurring, said: "The entire strength of the nation may be used to enforce in any part of the land the full and free exercise of all national powers and the security of all rights intrusted by the Constitution to its care. The strong arm of the national government may be put forth to brush away all obstructions to the freedom of interstate commerce or the transportation of the mails. If the emergency arises, the army of the nation, and all its militia, are at the service of the nation to compel obedience to its laws."

The means employed in respect of the combinations forbidden by the Anti-Trust Act, and which Congress deemed germane to the end to be accomplished, was to prescribe as *a rule* for *interstate and international* commerce (not for domestic commerce) that it should not be vexed by combinations, conspiracies or monopolies which restrain commerce by destroying or restricting competition. We say that Congress has prescribed such a rule, because, in all the prior cases in this court, the Anti-Trust Act has been construed as forbidding any combination which, by its necessary operation, destroys or restricts free competition among those engaged in interstate commerce; in other words, that to destroy or restrict free competition in interstate commerce was to restrain such commerce. Now, can this court say that such a rule is prohibited by the Constitution or is not one that Congress could appropriately prescribe when exerting its power under the commerce clause of the Constitution? Whether the free operation of the normal laws of competition is a wise and wholesome rule for trade and commerce is an economic question which this court need not consider or determine. Undoubtedly, there are those who think that the general

business interests and prosperity of the country will be best promoted if the rule of competition is not applied. But there are others who believe that such a rule is more necessary in these days of enormous wealth than it ever was in any former period of our history. Be all this as it may, Congress has, in effect, recognized the rule of free competition by declaring illegal every combination or conspiracy in restraint of interstate and international commerce. As, in the judgment of Congress, the public convenience and the general welfare will be best subserved when the natural laws of competition are left undisturbed by those engaged in interstate commerce, and as Congress has embodied that rule in a statute, that must be, for all, the end of the matter, if this is to remain a government of laws, and not of men.

It is said that railroad corporations created under the laws of a state can only be consolidated with the authority of the state. Why that suggestion is made in this case we cannot understand, for there is no pretence that the combination here in question was under the authority of the states under whose laws these railroad corporations were created. But even if the state allowed consolidation, it would not follow that the stockholders of two or more state railroad corporations, having *competing lines and engaged in interstate commerce*, could lawfully combine and form a distinct corporation to hold the stock of the constituent corporations, and, by destroying competition between them, in violation of the act of Congress, restrain commerce among the states and with foreign nations.

The rule of competition, prescribed by Congress, was not at all new in trade and commerce. And we cannot be in any doubt as to the reason that moved Congress to the incorporation of that rule into a statute. That reason was thus stated in *United States* v. *Joint Traffic Asso.:* "Has not Congress, with regard to interstate commerce, and in the course of regulating it, in the case of railroad corporations, the power to say that no contract or combination shall be legal which shall restrain trade and commerce by shutting out the operation of the general law of competition? We think it has. . . . It is the combination of these large and powerful corporations, covering vast sections

of territory and influencing trade throughout the whole extent thereof, and acting *as one body* in all the matters over which the combination extends, that constitutes the alleged evil, and in regard to which, *so far as the combination operates upon and restrains interstate commerce*, Congress has power to legislate and to prohibit." Pages 569, 571, L. ed., pages 287, 288, Sup. Ct. Rep., page 32. That such a rule was applied to interstate commerce should not have surprised any one. Indeed, when Congress declared contracts, combinations and conspiracies in restraint of trade or commerce to be illegal, it did nothing more than apply to interstate commerce a rule that had been long applied by the several states when dealing with combinations that were in restraint of their domestic commerce. The decisions in state courts upon this general subject are not only numerous and instructive, but they show the circumstances under which the Anti-Trust Act was passed. It may well be assumed that Congress, when enacting that statute, shared the general apprehension that a few powerful corporations or combinations sought to obtain, and, unless restrained, would obtain, such absolute control of the entire trade and commerce of the country as would be detrimental to the general welfare.

In *Morris Run Coal Co.* v. *Barclay Coal Co.*, 68 Pa., 173, 186, the supreme court of Pennsylvania dealt with a combination of coal companies seeking the control, within a large territory, of the entire market for bituminous coal. The court, observing that the combination was wide in its scope, general in its influence, and injurious in its effects, said: "When competition is left free, individual error or folly will generally find a correction in the conduct of others. But here is a combination of all the companies operating in the Blossburg and Barclay mining regions, and controlling their entire productions. They have combined together to govern the supply and the price of coal in all the markets from the Hudson to the Mississippi rivers, and from Pennsylvania to the Lakes. This combination has a power in its confederated form which no individual action can confer. The public interest must succumb to it, for it has left no competition free to correct its baleful influence. When the supply of coal is suspended the

demand for it becomes importunate, and prices must rise. Or if the supply goes forward, the price fixed by the confederates must accompany it. The domestic hearth, the furnaces of the iron master and the fires of the manufacturer all feel the restraint, while many dependent hands are paralyzed and hungry mouths are stinted. The influence of a lack of supply or a rise in the price of an article of such prime necessity cannot be measured. It permeates the entire mass of the community, and leaves few of its members untouched by its withering blight. Such a combination is more than a contract; it is an offence. . . . In all such combinations where the purpose is injurious or unlawful, the gist of the offence is the conspiracy. Men can often do by the *combination* of many what, severally, no one could accomplish, and even what, when done by one, would be innocent. . . . *There is a potency in numbers when combined* which the law cannot overlook, where injury is the consequence." The same principles were applied in *Arnot* v. *Pittston & E. Coal Co.*, 68 N. Y., 558, 565, 23 Am. Rep., 190, 194, which was the case of a combination of two coal companies in order to give one of them a monopoly of coal in a particular region, the court of appeals of New York holding that "a combination to effect such a purpose is inimical to the interests of the public, and that all contracts designed to effect such an end are contrary to public policy, and therefore illegal." They were also applied by the supreme court of Ohio in *Central Ohio Salt Co.* v. *Guthrie*, 35 Ohio St., 666, 672, which was the case of a combination among manufacturers of salt in a large salt-producing territory, the court saying: "It is no answer to say that competition in the salt trade was not in fact destroyed, or that the price of the commodity was not unreasonably advanced. *Courts will not stop to inquire as to the degree of injury inflicted upon the public; it is enough to know that the inevitable tendency of such contracts is injurious to the public.*"

So, in *Craft* v. *McConoughy*, 79 Ill., 346, 350, 22 Am. Rep., 171, 174, which was the case of a combination among grain dealers by which competition was stifled, the court saying: "So long as competition was free, the interest of the public was safe. The laws of trade, in connection with the rigor of competition,

was all the guaranty the public required; but the secret combination created by the contract destroyed all competition, and created a monopoly against which the public interest had no protection." Again, in *People ex rel. Peabody* v. *Chicago Gas Trust Co.*, 130 Ill., 269, 297, 8 L. R. A., 497, 506, 22 N. E., 798, 804, which involved the validity of the organization of a gas corporation which obtained a monopoly in the business of furnishing illuminating gas in the city of Chicago by buying the stock of four other gas companies, it was said: "Of what avail is it that any number of gas companies may be formed under the general incorporation law, if a giant trust company can be clothed with the power of buying up and holding the stock and property of such companies, and, through the control thereby attained, can direct all their operations and weld them into one huge combination?" To the same effect are cases almost too numerous to be cited. But among them we refer to *Richardson* v. *Buhl*, 77 Mich., 632, 6 L. R. A., 457, 43 N. W., 1102, which was the case of the organization of a corporation in Connecticut to unite in one corporation all the match manufacturers in the United States, and thus to obtain control of the business of manufacturing matches; *Santa Clara Valley Mill & Lumber Co.* v. *Hayes*, 76 Cal., 387, 390, 18 Pac., 391, which was the case of a combination among manufacturers of lumber, by which it could control the business in certain localities; and *India Bagging Asso.* v. *Kock*, 14 La. Ann., 164, which was the case of a combination among various commercial firms to control the prices of bagging used by cotton planters.

The cases just cited, it is true, relate to the domestic commerce of the states. But they serve to show the authority which the states possess to guard the public against *combinations* that repress individual enterprise and interfere with the operation of the natural laws of competition among those engaged in trade within its limits. They serve also to give point to the declaration of this court in *Gibbons* v. *Ogden*, 9 Wheat. 197, 6 L. ed., 70, — a principle never modified by any subsequent decision, — that, subject to the limitations imposed by the Constitution upon the exercise of the powers granted by that instrument, "the power over commerce with foreign nations

and among the several states is vested in Congress as absolutely as it would be in a single government having in its constitution the same restrictions on the exercise of the power as are found in the Constitution of the United States." Is there, then, any escape from the conclusion that, subject only to such restrictions, the power of Congress over interstate and international commerce is as full and complete as is the power of any state over its domestic commerce? If a state may strike down combinations that restrain its domestic commerce by destroying free competition among those engaged in such commerce, what power, except that of Congress, is competent to protect the freedom of interstate and international commerce when assailed by a combination that restrains such commerce by stifling competition among those engaged in it?

Now, the court is asked to adjudge that, if held to embrace the case before us, the Anti-Trust Act is repugnant to the Constitution of the United States. In this view we are unable to concur. The contention of the defendants could not be sustained without, in effect, overruling the prior decisions of this court as to the scope and validity of the Anti-Trust Act. If, as the court has held, Congress can strike down a combination between private persons or private corporations that restrains trade among the states in iron pipe (as in *Addyston Pipe & Steel Co.* v. *United States*) or in tiles, grates and mantels (as in *W. W. Montague & Co.* v. *Lowry*), surely it ought not to be doubted that Congress has power to declare illegal a combination that restrains commerce among the states, and with foreign nations, as carried on over the lines of competing railroad companies exercising public franchises, and engaged in such commerce. We cannot agree that Congress may strike down combinations among manufacturers and dealers in iron pipe, tiles, grates and mantels that restrain commerce among the states in such articles, but may not strike down combinations among stockholders of competing railroad carriers, which restrain commerce as involved in the transportation of passengers and property among the several states. If private parties may not, by combination among themselves, restrain interstate and international commerce in violation of an act of Congress, much less can such restraint be

tolerated when imposed, or attempted to be imposed, upon commerce as carried on over public highways. Indeed, if the contentions of the defendants are sound, why may not *all* the railway companies in the United States, that are engaged, under state charters, in interstate and international commerce, enter into a combination such as the one here in question, and, by the device of a holding corporation, obtain the absolute control throughout the entire country of rates for passengers and freight, beyond the power of Congress to protect the public against their exactions? The argument in behalf of the defendants necessarily leads to such results, and places Congress, although invested by the people of the United States with full authority to regulate interstate and international commerce, in a condition of utter helplessness, so far as the protection of the public against such combinations is concerned.

Will it be said that Congress can meet such emergencies by prescribing the rates by which interstate carriers shall be governed in the transportation of freight and passengers? If Congress has the power to fix such rates — and upon that question we express no opinion — it does not choose to exercise its power in that way or to that extent. It has, all will agree, a large discretion as to the means to be employed in the exercise of any power granted to it. For the present, it has determined to go no farther than to protect the freedom of commerce among the states and with foreign states by declaring illegal all contracts, combinations, conspiracies or monopolies in restraint of such commerce, and make it a public offence to violate the rule thus prescribed. How much further it may go, we do not now say. We need only at this time consider whether it has exceeded its powers in enacting the statute here in question.

Assuming, without further discussion, that the case before us is within the terms of the act, and that the act is not in excess of the powers of Congress, we recur to the question, How far may the courts go in reaching and suppressing the combination described in the bill? All will agree that if the Anti-Trust Act be constitutional, and if the combination in question be in violation of its provisions, the courts may enforce the provisions of the statute by such orders and decrees as are necessary or

appropriate to that end and as may be consistent with the fundamental rules of legal procedure. And all, we take it, will agree, as established firmly by the decisions of this court, that the power of Congress over commerce extends to all the instrumentalities of such commerce, and to every device that many be employed to interfere with the freedom of commerce among the states and with foreign nations. Equally, we assume, all will agree that the Constitution and the legal enactments of Congress are, by express words of the Constitution, the supreme law of the land, anything in the constitution and laws of any state to the contrary notwithstanding. Nevertheless, the defendants, strangely enough, invoke in their behalf the 10th Amendment of the Constitution, which declares that "the powers not delegated to the United States by the Constitution, nor prohibited by it to the states, are reserved to the states respectively or to the people"; and we are confronted with the suggestion that any order or decree of the Federal court which will prevent the Northern Securities Company from exercising the power it acquired in becoming the holder of the stocks of the Great Northern and Northern Pacific Railway Companies will be an invasion of the rights of the state under which the Securities company was chartered, as well as of the rights of the states creating the other companies. In other words, if the state of New Jersey gives a charter to a corporation, and even if the obtaining of such charter is in fact pursuant to a *combination* under which it becomes the holder of the stocks of shareholders in two competing, parallel railroad companies engaged in interstate commerce in other states, whereby competition between the respective roads of those companies is to be destroyed and the enormous commerce carried on over them restrained by suppressing competition, Congress must stay its hands and allow such restraint to continue, to the detriment of the public, because, forsooth, the corporations concerned or some of them are state corporations. We cannot conceive how it is possible for any one to seriously contend for such a proposition. It means nothing less than that Congress, in regulating interstate commerce, must act in subordination to the will of the states when exerting their power to create corporations. No such view can be entertained for a moment.

It is proper to say in passing that nothing in the record tends to show that the state of New Jersey had any reason to suspect that those who took advantage of its liberal incorporation laws had in view, when organizing the Securities company, to destroy competition between two great railway carriers engaged in interstate commerce in distant states of the Union. The purpose of the combination was concealed under very general words that gave no clew whatever to the real purposes of those who brought about the organization of the Securities company. If the certificate of incorporation of that company had expressly stated that the object of the company was to destroy competition between competing, parallel lines of interstate carriers, all would have seen, at the outset, that the scheme was in hostility to the national authority, and that there was a purpose to violate or evade the act of Congress.

We reject any such view of the relations of the national government and the states composing the Union as that for which the defendants contend. Such a view cannot be maintained without destroying the just authority of the United States. It is inconsistent with all the decisions of this court as to the powers of the national government over matters committed to it. No state can, by merely creating a corporation, or in any other mode, project its authority into other states, and across the continent, so as to prevent Congress from exerting the power it possesses under the Constitution over interstate and international commerce, or so as to exempt its corporation engaged in interstate commerce from obedience to any rule lawfully established by Congress for such commerce. It cannot be said that any state may give a corporation, created under its laws, authority to restrain interstate or international commerce against the will of the nation as lawfully expressed by Congress. Every corporation created by a state is necessarily subject to the supreme law of the land. And yet the suggestion is made that to restrain a state corporation from interfering with the free course of trade and commerce among the states, in violation of an act of Congress, is hostile to the reserved rights of the states. The Federal court may not have power to forfeit the charter of the Securities company; it may not declare how its shares of

stock may be transferred on its books, nor prohibit it from acquiring real estate, nor diminish or increase its capital stock. All these and like matters are to be regulated by the state which created the company. But to the end that effect be given to the national will, lawfully expressed, Congress may prevent that company, in its capacity as a holding corporation and trustee, from carrying out the purposes of a combination formed in restraint of interstate commerce. The Securities company is itself a part of the present combination; its head and front; its trustee. It would be extraordinary if the court, in executing the act of Congress, could not lay hands upon that company and prevent it from doing that which, if done, will defeat the act of Congress. Upon like grounds the court can, by appropriate orders, prevent the two competing railroad companies here involved from cooperating with the Securities company in restraining commerce among the states. In short, the court may make any order necessary to bring about the dissolution or suppression of an illegal combination that restrains interstate commerce. All this can be done without infringing in any degree upon the just authority of the states. The affirmance of the judgment below will only mean that no combination, however powerful, is stronger than the law, or will be permitted to avail itself of the pretext that to prevent it doing that which, if done, would defeat a legal enactment of Congress, is to attack the reserved right of the states. It would mean that the government which represents all, can, when acting within the limits of its powers, compel obedience to its authority. It would mean that no device in evasion of its provisions, however skilfully such device may have been contrived, and no combination, by whomsoever formed, is beyond the reach of the supreme law of the land, if such device or combination, by its operation, directly restrains commerce among the states or with foreign nations in violation of the act of Congress.

The defendants rely, with some confidence, upon the case of the *Baltimore & O. R. Co.* v. *Maryland*, 21 Wall., 456, 473, 22 L. ed., 678, 684. But nothing we have said is inconsistent with any principle announced in that case. The court there recognized the principle that a state has plenary powers "over its

own territory, its highways, its franchises and its corporations," and observed that "we are bound to sustain the constitutional powers and prerogatives of the states, as well as those of the United States, whenever they are brought before us for adjudication, no matter what may be the consequences." Of course, every state has, in a general sense, plenary power over its corporations. But is it conceivable that a state, when exerting power over a corporation of its creation, may prevent or embarrass the exercise by Congress of any power with which it is invested by the Constitution? In the case just referred to the court does not say, and it is not to be supposed that it will ever say, that any power exists with a state to prevent the enforcement of a lawful enactment of Congress, or to invest any of its corporations, in whatever business engaged, with authority to disregard such enactment or defeat its legitimate operation. On the contrary, the court has steadily held to the doctrine, vital to the United States as well as to the states, that a state enactment, even if passed in the exercise of its acknowledged powers, must yield, in case of conflict, to the supremacy of the Constitution of the United States and the acts of Congress enacted in pursuance of its provisions. This results, the court has said, as well from the nature of the government as from the words of the Constitution. *Gibbons* v. *Ogden*, 9 Wheat., 1, 210, 6 L. ed., 23, 73; *Sinnot* v. *Davenport*, 22 How, 227, 243, 16 L. ed., 243, 247; *Re Debs*, 158 U. S., 564, 39 L. ed, 1092, 15 Sup. Ct. Rep., 900; *Missouri, K. & T. R. Co.* v. *Haber*, 169 U. S., 613, 626, 627, 42 L. ed., 878, 883, 18 Sup. Ct. Rep., 488. In *Texas* v. *White*, 7 Wall., 700, 725, 19 L. ed., 227, 237, the court remarked "that 'the people of each state compose a state, having its own government, and endowed with all the functions essential to separate and independent existence,' and that 'without the states in union, there could be no such political body as the United States.' *Lane County* v. *Oregon*, 7 Wall., 76, 19 L. ed., 104. Not only, therefore, can there be no loss of separate and independent autonomy to the states, through their union under the Constitution, but it may be not unreasonably said that the preservation of the states, and the maintenance of their governments, are as much within the design and care of the Constitution

as the preservation of the Union and the maintenance of the national government." These doctrines are at the basis of our constitutional government, and cannot be disregarded with safety.

The defendants also rely on *Louisville & N. R. Co.* v. *Kentucky*, 161 U. S., 677, 702, 40 L. ed., 849, 859, 16 Sup. Ct. Rep., 714, 724. In that case it was contended by the railroad company that the assumption of the state to forbid the consolidation of parallel and competing lines was an interference with the power of Congress over interstate commerce. The court observed that but little need be said in answer to such a proposition, for "it has never been supposed that the dominant power of Congress over interstate commerce took from the states the power of legislation with respect to the instruments of such commerce, so far as the legislation was within its ordinary police powers." But that case distinctly recognized that there was a division of power between Congress and the states in respect to interstate railways, and that Congress had the superior right to control that commerce and forbid interference therewith, while to the states remained the power to create and to regulate the instruments of such commerce, so far as necessary to the conservation of the public interests. If there is anything in that case which even intimates that a state or a state corporation may in any way directly restrain interstate commerce, over which Congress has, by the Constitution, complete control, we have been unable to find it.

The question of the relations of the general government with the states is again presented by the specific contention of each defendant that Congress did not intend "to limit the power of the several states to create corporations, define their purposes, fix the amount of their capital, and determine who may buy, own and sell their stock." All that is true, generally speaking, but the contention falls far short of meeting the controlling questions in this case. To meet this contention we must repeat some things already said in this opinion. But if what we have said be sound, repetition will do no harm. So far as the Constitution of the United States is concerned, a state may, indeed, create a corporation, define its powers, prescribe

the amount of its stock and the mode in which it may be transferred It may even authorize one of its corporations to engage in commerce of every kind, — domestic, interstate and international. The regulation or control of purely domestic commerce of a state is, of course, with the state, and Congress has no direct power over it so long as what is done by the state does not interfere with the operations of the general government, or any legal enactment of Congress. A state, if it chooses so to do, may even submit to the existence of combinations within its limits that restrain its internal trade. But neither a state corporation nor its stockholders can, by reason of the nonaction of the state or by means of any combination among such stockholders, interfere with the complete enforcement of any rule lawfully devised by Congress for the conduct of commerce among the states or with foreign nations; for, as we have seen, interstate and international commerce is, by the Constitution, under the control of Congress, and it belongs to the legislative department of the government to prescribe rules for the conduct of that commerce. If it were otherwise, the declaration in the Constitution of its supremacy, and of the supremacy as well of the laws made in pursuance of its provisions, was a waste of words. Whilst every instrumentality of domestic commerce is subject to state control, every instrumentality of interstate commerce may be reached and controlled by national authority, *so far as to compel it to respect the rules for such commerce lawfully established by Congress.* No corporate person can excuse a departure from or violation of that rule under the plea that that which it has done or omitted to do is permitted, or not forbidden, by the state under whose authority it came into existence. We repeat that no state can endow any of its corporations, or any combination of its citizens, with authority to restrain interstate or international commerce, or to disobey the national will as manifested in legal enactments of Congress. So long as Congress keeps within the limits of its authority as defined by the Constitution, infringing no rights recognized or secured by that instrument, its regulations of interstate and international commerce, whether founded in wisdom or not, must be submitted to by all. Harm, and only harm, can come from the

failure of the courts to recognize this fundamental principle of constitutional construction. To depart from it because of the circumstances of special cases, or because the rule, in its operation, may possibly affect the interests of business, is to endanger the safety and integrity of our institutions and make the Constitution mean not what it says, but what interested parties wish it to mean at a particular time and under particular circumstances. The supremacy of the law is the foundation rock upon which our institutions rest. The law, this court said in *United States* v. *Lee*, 106 U. S., 196, 220, 27 L. ed., 171, 181, 1 Sup. Ct. Rep., 240, is the only supreme power in our system of government. And no higher duty rests upon this court than to enforce, by its decrees, the will of the legislative department of the government, as expressed in a statute, unless such statute be plainly and unmistakably in violation of the Constitution. If the statute is beyond the constitutional power of Congress, the court would fail in the performance of a solemn duty if it did not so declare. But if nothing more can be said than that Congress has erred,—and the court must not be understood as saying that it has or has not erred,—the remedy for the error and the attendant mischief is the selection of new senators and representatives, who, by legislation, will make ~~such~~ changes in existing statutes, or adopt such new statutes, as may be demanded by their constituents and be consistent with law.

Many suggestions were made in argument based upon the thought that the Anti-Trust Act would, in the end, prove to be mischievous in its consequences. Disaster to business and widespread financial ruin, it has been intimated, will follow the execution of its provisions. Such predictions were made in all the cases heretofore arising under that act. But they have not been verified. It is the history of monopolies in this country and in England that predictions of ruin are habitually made by them when it is attempted, by legislation, to restrain their operations and to protect the public against their exactions. In this, as in former cases, they seek shelter behind the reserved rights of the states and even behind the constitutional guaranty of liberty of contract. But this court has heretofore adjudged that the act of Congress did not touch the rights of the states, and that lib-

erty of contract did not involve a right to deprive the public of the advantages of free competition in trade and commerce. Liberty of contract does not imply liberty in a corporation or individuals to defy the national will, when legally expressed. Nor does the enforcement of a legal enactment of Congress infringe, in any proper sense, the general inherent right of every one to acquire and hold property. That right, like all other rights, must be exercised in subordination to the law.

But even if the court shared the gloomy forebodings in which the defendants indulge, it could not refuse to respect the action of the legislative branch of the government if what it has done is within the limits of its constitutional power. The suggestions of disaster to business have, we apprehend, their origin in the zeal of parties who are opposed to the policy underlying the act of Congress or are interested in the result of this particular case; at any rate, the suggestions imply that the court may and ought to refuse the enforcement of the provisions of the act if, in its judgment, Congress was not wise in prescribing as a rule by which the conduct of interstate and international commerce is to be governed, that every combination, whatever its form, in restraint of such commerce and the monopolizing or attempting to monopolize such commerce, shall be illegal. These, plainly, are questions as to the policy of legislation which belong to another department, and this court has no function to supervise such legislation from the standpoint of wisdom or policy. We need only say that Congress has authority to declare, and by the language of its act, as interpreted in prior cases, has, in effect, declared, that the freedom of interstate and international commerce shall not be obstructed or disturbed by any combination, conspiracy or monopoly that will restrain such commerce, by preventing the free operation of competition among interstate carriers engaged in the transportation of passengers and freight. This court cannot disregard that declaration unless Congress, in passing the statute in question, be held to have transgressed the limits prescribed for its action by the Constitution. But, as already indicated, it cannot be so held consistently with the provisions of that instrument.

The combination here in question may have been for the

pecuniary benefit of those who formed or caused it to be formed. But the interests of private persons and corporations cannot be made paramount to the interests of the general public. Under the Articles of Confederation commerce among the original states was subject to vexatious and local regulations that took no account of the general welfare. But it was for the protection of the general interests, as involved in interstate and international commerce, that Congress, representing the whole country, was given by the Constitution full power to regulate commerce among the states and with foreign nations. In *Brown* v. *Maryland*, 12 Wheat., 419, 446, 6 L. ed., 678, 688, it was said: "Those who felt the injury arising from this state of things, and those who were capable of estimating the influence of commerce on the prosperity of nations, perceived the necessity of giving the control over this important subject to a single government. It may be doubted whether any of the evils proceeding from the feebleness of the Federal government contributed more to that great revolution which introduced the present system than the deep and general conviction that commerce ought to be regulated by Congress." Railroad companies, we said in the Trans-Missouri Freight Asso. case, "are instruments of commerce, and their business is commerce itself." And such companies, it must be remembered, operate "public highways, established primarily for the convenience of the people, and therefore are subject to governmental control and regulation."

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When such carriers, in the exercise of public franchises, engage in the transportation of passengers and freight among the states, they become — even if they be state corporations — subject to such rules as Congress may lawfully establish for the conduct of interstate commerce.

It was said in argument that the circumstances under which the Northern Securities Company obtained the stock of the constituent companies imported simply an investment in the stock of other corporations, — a purchase of that stock; which investment or purchase, it is contended, was not forbidden by the

charter of the company, and could not be made illegal by any act of Congress. This view is wholly fallacious, and does not comport with the actual transaction. There was no actual investment, in any substantial sense, by the Northern Securities Company in the stock of the two constituent companies. If it was, in form, such a transaction, it was not, in fact, one of that kind. However that company may have acquired for itself any stock in the Great Northern and Northern Pacific Railway Companies, no matter how it obtained the means to do so, all the stock it held or acquired in the constituent companies was acquired and held to be used in suppressing competition between those companies. It came into existence only for that purpose. If any one had full knowledge of what was designed to be accomplished, and as to what was actually accomplished, by the combination in question, it was the defendant Morgan. In his testimony he was asked, "Why put the stocks of *both* these [constituent companies] into one holding company?" He frankly answered, "In the first place, this holding company was simply a question of *custodian*, because it had no other alliances." That disclosed the actual nature of the transaction, which was only to organize the Northern Securities Company as a *holding* company, in whose hands, not as a real purchaser or absolute owner, but simply as custodian, were to be placed the stocks of the constituent companies, — such custodian to represent the combination formed between the shareholders of the constituent companies, the direct and necessary effect of such combination being, as already indicated, to restrain and monopolize interstate commerce by suppressing, or (to use the words of this court in *United States* v. *Joint Traffic Asso.*) "smothering" competition between the lines of two railway carriers.

We will now inquire as to the nature and extent of the relief granted to the government by the decree below.

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Guided by these long-established rules of construction, it is manifest that if the Anti-Trust Act is held not to embrace a case such as is now before us, the plain intention of the legislative branch of the government will be defeated. If Congress has

not, by the words used in the act, described this and like cases, it would, we apprehend, be impossible to find words that would describe them. This, it must be remembered, is a suit in equity, instituted by authority of Congress "to prevent and restrain violations of the act," § 4; and the court, in virtue of a well-settled rule governing proceedings in equity, may mould its decree so as to accomplish practical results, — such results as law and justice demand. The defendants have no just cause to complain of the decree, in matter of law, and it should be affirmed.

The judgment of the court is that the decree below be and hereby is affirmed, with liberty to the circuit court to proceed in the execution of its decree as the circumstances may require.

Affirmed.

Mr. Justice Brewer, concurring:

I cannot assent to all that is said in the opinion just announced, and believe that the importance of the case and the questions involved justify a brief statement of my views.

First, let me say that while I was with the majority of the court in the decision in *United States* v. *Trans-Missouri Freight Asso., etc.,* . . . and while a further examination (which has been induced by the able and exhaustive arguments of counsel in the present case) has not disturbed the conviction that those cases were rightly decided, I think that in some respects the reasons given for the judgments cannot be sustained. Instead of holding that the Anti-Trust Act included all contracts, reasonable or unreasonable, in restraint of interstate trade, the ruling should have been that the contracts there presented were unreasonable restraints of interstate trade, and as such within the scope of the act. That act, as appears from its title, was levelled at only "unlawful restraints and monopolies." Congress did not intend to reach and destroy those minor contracts in partial restraint of trade which the long course of decisions at common law had affirmed were reasonable and ought to be upheld. The purpose rather was to place a statutory prohibition, with prescribed penalties and remedies, upon those contracts which were in direct restraint of trade, unrea-

sonable, and against public policy. Whenever a departure from common-law rules and definitions is claimed, the purpose to make the departure should be clearly shown. Such a purpose does not appear, and such a departure was not intended.

Further, the general language of the act is also limited by the power which each individual has to manage his own property and determine the place and manner of its investment. Freedom of action in these respects is among the inalienable rights of every citizen. If, applying this thought to the present case, it appeared that Mr. Hill was the owner of a majority of the stock in the Great Northern Railway Company, he could not, by any act of Congress, be deprived of the right of investing his surplus means in the purchase of stock of the Northern Pacific Railway Company, although such purchase might tend to vest in him through that ownership a control over both companies. In other words, the right which all other citizens had, of purchasing Northern Pacific stock, could not be denied to him by Congress because of his ownership of stock in the Great Northern Company. Such was the ruling in *Pearsall* v. *Great Northern R. Co.*, 161 U. S., 646, 40 L. ed., 838, 16 Sup. Ct. Rep., 705, in which this court said (page 671, L. ed., page 847, Sup. Ct. Rep., 712), in reference to the right of the stockholders of the Great Northern Company to purchase the stock of the Northern Pacific Railway Company, "Doubtless these stockholders could lawfully acquire, by individual purchases, a majority or even the whole of the stock of the reorganized company, and thus possibly obtain its ultimate control; but the companies would still remain separate corporations, with no interests, as such, in common."

But no such investment by a single individual of his means is here presented. There was a combination by several individuals, separately owning stock in two competing railroad companies, to place the control of both in a single corporation. The purpose to combine, and by combination destroy competition, existed before the organization of the corporation, the Securities company. That corporation, though nominally having a capital stock of $400,000,000, had no means of its own; $30,000 in cash was put into its treasury, but simply for the expenses of

organization. The organizers might just as well have made the nominal stock a thousand millions as four hundred, and the corporation would have been no richer or poorer. A corporation, while by fiction of law recognized for some purposes as a person, and, for purposes of jurisdiction, as a citizen, is not endowed with the inalienable rights of a natural person. It is an artificial person, created and existing only for the convenient transaction of business. In this case it was a mere instrumentality by which separate railroad properties were combined under one control. That combination is as direct a restraint of trade by destroying competition as the appointment of a committee to regulate rates. The prohibition of such a combination is not at all inconsistent with the right of an individual to purchase stock. The transfer of stock to the Securities company was a mere incident, the manner in which the combination to destroy competition, and thus unlawfully restrain trade, was carried out.

If the parties interested in these two railroad companies can, through the instrumentality of a holding corporation, place both under one control, then in like manner, as was conceded on the argument by one of the counsel for the appellants, could the control of all the railroad companies in the country be placed in a single corporation. Nor need this arrangement for control stop with what has already been done. The holders of $201,000,000 of stock in the Northern Securities Company might organize another corporation to hold their stock in that company, and the new corporation, holding the majority of the stock in the Northern Securities Company, and acting in obedience to the wishes of a majority of its stockholders, would control the action of the Securities company and through it the action of the two railroad companies; and this process might be extended until a single corporation whose stock was owned by three or four parties would be in practical control of both roads; or, having before us the possibilities of combination, the control of the whole transportation system of the country. I cannot believe that to be a reasonable or lawful restraint of trade.

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I have felt constrained to make these observations for fear

that the broad and sweeping language of the opinion of the court might tend to unsettle legitimate business enterprises, stifle or retard wholesome business activities, encourage improper disregard of reasonable contracts, and invite unnecessary litigation.

Mr. Justice Holmes, with whom concurred the Chief Justice, Mr. Justice White, and Mr. Justice Peckham, dissenting:

I am unable to agree with the judgment of the majority of the court, and although I think it useless and undesirable, as a rule, to express dissent, I feel bound to do so in this case and to give my reasons for it.

Great cases, like hard cases, make bad law. For great cases are called great, not by reason of their real importance in shaping the law of the future, but because of some accident of immediate overwhelming interest which appeals to the feelings and distorts the judgment. These immediate interests exercise a kind of hydraulic pressure which makes what previously was clear seem doubtful, and before which even well-settled principles of law will bend. What we have to do in this case is to find the meaning of some not very difficult words. We must try, — I have tried, — to do it with the same freedom of natural and spontaneous interpretation that one would be sure of if the same question arose upon an indictment for a similar act which excited no public attention, and was of importance only to a prisoner before the court. Furthermore, while at times judges need for their work the training of economists or statesmen, and must act in view of their foresight of consequences, yet, when their task is to interpret and apply the words of a statute, their function is merely academic to begin with, — to read English intelligently, — and a consideration of consequences comes into play, if at all, only when the meaning of the words used is open to reasonable doubt.

The question to be decided is whether, under the act of July 2, 1890 (26 Stat. at L., 209, chap. 647, U. S. Comp. Stat., 1901, page 3200), it is unlawful, at any stage of the process, if several men unite to form a corporation for the purpose of buying more than half the stock of each of two competing interstate railroad

companies, if they form the corporation, and the corporation buys the stock. I will suppose further that every step is taken, from the beginning, with the single intent of ending competition between the companies. I make this addition not because it may not be and is not disputed, but because, as I shall try to show, it is totally unimportant under any part of the statute with which we have to deal.

The statute of which we have to find the meaning is a criminal statute. The two sections on which the government relies both make certain acts crimes. That is their immediate purpose and that is what they say. It is vain to insist that this is not a criminal proceeding. The words cannot be read one way in a suit which is to end in fine and imprisonment and another way in one which seeks an injunction. The construction which is adopted in this case must be adopted in one of the other sort. I am no friend of artificial interpretations because a statute is of one kind rather than another, but all agree that before a statute is to be taken to punish that which always has been lawful, it must express its intent in clear words. So I say we must read the words before us as if the question were whether two small exporting grocers should go to jail.

Again, the statute is of a very sweeping and general character. It hits "every" contract or combination of the prohibited sort, great or small, and "every" person who shall monopolize or attempt to monopolize, in the sense of the act, "any part" of the trade or commerce among the several states. There is a natural inclination to assume that it was directed against certain great combinations, and to read it in that light. It does not say so. On the contrary, it says "every," and "any part." Still less was it directed specially against railroads. There even was a reasonable doubt whether it included railroads until the point was decided by this court.

Finally, the statute must be construed in such a way as not merely to save its constitutionality, but, so far as is consistent with a fair interpretation, not to raise grave doubts on that score. I assume, for the purposes of discussion, although it would be a great and serious step to take, that in some case that seemed to it to need heroic measures, Congress might regulate not only

commerce, but instruments of commerce, or contracts the bearing of which upon commerce would be only indirect. But it is clear that the mere fact of an indirect effect upon commerce, not shown to be certain and very great, would not justify such a law. The point decided in *United States* v. *E. C. Knight Co.*, 156 U. S., 1, 17, 39 L. ed., 325, 331, 15 Sup. Ct. Rep., 249, 255, was that "the fact . . . that trade or commerce might be indirectly affected was not enough to entitle complainants to a decree." Commerce depends upon population, but Congress could not, on that ground, undertake to regulate marriage and divorce. If the act before us is to be carried out according to what seems to me the logic of the argument for the government, which I do not believe that it will be, I can see no part of the conduct of life with which, on similar principles, Congress might not interfere.

This act is construed by the government to affect the purchasers of shares in two railroad companies because of the effect it may have, or, if you like, is certain to have, upon the competition of these roads. If such a remote result of the exercise of an ordinary incident of property and personal freedom is enough to make that exercise unlawful, there is hardly any transaction concerning commerce between the states that may not be made a crime by the finding of a jury or a court. The personal ascendency of one man may be such that it would give to his advice the effect of a command, if he owned but a single share in each road. The tendency of his presence in the stockholders' meetings might be certain to prevent competition, and thus his advice, if not his mere existence, become a crime.

I state these general considerations as matters which I should have to take into account before I could agree to affirm the decree appealed from, but I do not need them for my own opinion, because, when I read the act I cannot feel sufficient doubt as to the meaning of the words to need to fortify my conclusion by any generalities. Their meaning seems to me plain on their face.

The first section makes "every contract, combination in the form of trust or otherwise, or conspiracy in restraint of trade or commerce among the several states, or with foreign nations" a

misdemeanor, punishable by fine, imprisonment, or both. Much trouble is made by substituting other phrases assumed to be equivalent, which then are reasoned from as if they were in the act. The court below argued as if maintaining competition were the expressed object of the act. The act says nothing about competition. I stick to the exact words used. The words hit two classes of cases, and only two, — contracts in restraint of trade and combinations or conspiracies in restraint of trade, — and we have to consider what these respectively are. Contracts in restraint of trade are dealt with and defined by the common law. They are contracts with a stranger to the contractor's business (although, in some cases, carrying on a similar one), which wholly or partially restrict the freedom of the contractor in carrying on that business as otherwise he would. The objection of the common law to them was, primarily, on the contractor's own account. The notion of monopoly did not come in unless the contract covered the whole of England. *Mitchel* v. *Reynolds*, 1 P. Wms., 181. Of course, this objection did not apply to partnerships or other forms, if there were any, of substituting a community of interest where there had been competition. There was no objection to such combinations merely as in restraint of trade or otherwise unless they amounted to a monopoly. Contracts in restraint of trade, I repeat, were contracts with strangers to the contractor's business, and the trade restrained was the contractor's own.

Combinations or conspiracies in restraint of trade, on the other hand, were combinations to keep strangers to the agreement out of the business. The objection to them was not an objection to their effect upon the parties making the contract, the members of the combination or firm, but an objection to their intended effect upon strangers to the firm and their supposed consequent effect upon the public at large. In other words, they were regarded as contrary to public policy because they monopolized, or attempted to monopolize, some portion of the trade or commerce of the realm. See *United States* v. *E. C. Knight Co.* 156 U. S., 1, 39 L. ed., 325, 15 Sup. Ct. Rep., 249. All that is added to the first section by § 2 is that like penalties are imposed upon every single person who, without combination, monopolizes, or

attempts to monopolize, commerce among the states; and that the liability is extended to attempting to monopolize any part of such trade or commerce. It is more important as an aid to the construction of § 1 than it is on its own account. It shows that whatever is criminal when done by way of combination is equally criminal if done by a single man. That I am right in my interpretation of the words of § 1 is shown by the words "in the form of trust or otherwise." The prohibition was suggested by the trusts, the objection to which, as every one knows, was not the union of former competitors, but the sinister power exercised or supposed to be exercised by the combination in keeping rivals out of the business and ruining those who already were in. It was the ferocious extreme of competition with others, not the cessation of competition among the partners, that was the evil feared. Further proof is to be found in § 7, giving an action to any person injured in his business or property by the forbidden conduct. This cannot refer to the parties to the agreement, and plainly means that outsiders who are injured in their attempt to compete with a trust or other similar combination may recover for it. *W. W. Montague & Co.* v. *Lowry*, 193 U. S., 38; 24 Sup. Ct. Rep., 307. How effective the section may be or how far it goes is not material to my point. My general summary of the two classes of cases which the act affects is confirmed by the title, which is "An Act to Protect Trade and Commerce Against Unlawful Restraints and Monopolies."

What I now ask is under which of the foregoing classes this case is supposed to come; and that question must be answered as definitely and precisely as if we were dealing with the indictments which logically ought to follow this decision. The provision of the statute against contracts in restraint of trade has been held to apply to contracts between railroads, otherwise remaining independent, by which they restricted their respective freedom as to rates. This restriction by contract with a stranger to the contractor's business is the ground of the decision in *United States* v. *Joint Traffic Asso.*, 171 U. S., 505, 43 L. ed., 259, 19 Sup. Ct. Rep., 25, following and affirming *United States* v. *Trans-Missouri Freight Asso.*, 166 U. S., 290, 41 L. ed., 1007, 17 Sup. Ct. Rep., 540. I accept those decisions

absolutely, not only as binding upon me, but as decisions which I have no desire to criticise or abridge. But the provision has not been decided, and, it seems to me, could not be decided without a perversion of plain language, to apply to an arrangement by which competition is ended through community of interest, — an arrangement which leaves the parties without external restriction. That provision, taken alone, does not require that all existing competitions shall be maintained. It does not look primarily, if at all, to competition. It simply requires that a party's freedom in trade between the states shall not be cut down by contract with a stranger. So far as that phrase goes, it is lawful to abolish competition by any form of union. It would seem to me impossible to say that the words "every contract in restraint of trade is a crime, punishable with imprisonment," would send the members of a partnership between, or a consolidation of, two trading corporations to prison, — still more impossible to say that it forbade one man or corporation to purchase as much stock as he liked in both. Yet those words would have that effect if this clause of § 1 applies to the defendants here. For it cannot be too carefully remembered that that clause applies to "every" contract of the forbidden kind, — a consideration which was the turning point of the Trans-Missouri Freight Association's case.

If the statute applies to this case it must be because the parties, or some of them, have formed, or because the Northern Securities Company is, a combination in restraint of trade among the states, or, what comes to the same thing, in my opinion, because the defendants, or some or one of them, are monopolizing, or attempting to monopolize, some part of the commerce between the states. But the mere reading of those words shows that they are used in a limited and accurate sense. According to popular speech, every concern monopolizes whatever business it does, and if that business is trade between two states it monopolizes a part of the trade among the states. Of course, the statute does not forbid that. It does not mean that all business must cease. A single railroad down a narrow valley or through a mountain gorge monopolizes all the railroad transportation through that valley or gorge. Indeed, every railroad monopo-

lizes, in a popular sense, the trade of some area. Yet I suppose no one would say that the statute forbids a combination of men into a corporation to build and run such a railroad between the states.

I assume that the Minnesota charter of the Great Northern, and the Wisconsin charter of the Northern Pacific, both are valid. Suppose that, before either road was built, Minnesota, as part of a system of transportation between the states, had created a railroad company authorized singly to build all the lines in the states now actually built, owned or controlled by either of the two existing companies. I take it that that charter would have been just as good as the present one, even if the statutes which we are considering had been in force. In whatever sense it would have created a monopoly, the present charter does. It would have been a large one, but the act of Congress makes no discrimination according to size. Size has nothing to do with the matter. A monopoly of "any part" of commerce among the states is unlawful. The supposed company would have owned lines that might have been competing; probably the present one does. But the act of Congress will not be construed to mean the universal disintegration of society into single men, each at war with all the rest, or even the prevention of all further combinations for a common end.

There is a natural feeling that somehow or other the statute meant to strike at combinations great enough to cause just anxiety on the part of those who love their country more than money, while it viewed such little ones as I have supposed with just indifference. This notion, it may be said, somehow breathes from the pores of the act, although it seems to be contradicted in every way by the words in detail. And it has occurred to me that it might be that when a combination reached a certain size it might have attributed to it more of the character of a monopoly merely by virtue of its size than would be attributed to a smaller one. I am quite clear that it is only in connection with monopolies that size could play any part. But my answer has been indicated already. In the first place, size, in the case of railroads, is an inevitable incident; and if it were an objection under the act, the Great Northern and the Northern Pacific

already were too great and encountered the law. In the next place, in the case of railroads it is evident that the size of the combination is reached for other ends than those which would make them monopolies. The combinations are not formed for the purpose of excluding others from the field. Finally, even a small railroad will have the same tendency to exclude others from its narrow area that great ones have to exclude others from the greater one, and the statute attacks the small monopolies as well as the great. The very words of the act make such a distinction impossible in this case, and it has not been attempted in express terms.

If the charter which I have imagined above would have been good notwithstanding the monopoly, in a popular sense, which it created, one next is led to ask whether and why a combination or consolidation of existing roads, although in actual competition, into one company of exactly the same powers and extent, would be any more obnoxious to the law. Although it was decided in *Louisville & N. R. Co.* v. *Kentucky*, 161 U. S., 677, 701, 40 L. ed., 849, 859, 16 Sup. Ct. Rep., 714, that since the statute, as before, the states have the power to regulate the matter, it was said, in the argument, that such a consolidation would be unlawful, and it seems to me that the Attorney-General was compelled to say so in order to maintain his case. But I think that logic would not let him stop there, or short of denying the power of a state at the present time to authorize one company to construct and own two parallel lines that might compete. The monopoly would be the same as if the roads were consolidated after they had begun to compete; and it is on the footing of monopoly that I now am supposing the objection made. But to meet the objection to the prevention of competition at the same time, I will suppose that three parties apply to a state for charters; one for each of two new and possibly competing lines respectively, and one for both of these lines, and that the charter is granted to the last. I think that charter would be good, and I think the whole argument to the contrary rests on a popular instead of an accurate and legal conception of what the word "monopolize" in the statute means. I repeat, that in my opinion there is no attempt to monopolize, and what,

as I have said, in my judgment amounts to the same thing, that there is no combination in restraint of trade until something is done with the intent to exclude strangers to the combination from competing with it in some part of the business which it carries on.

Unless I am entirely wrong in my understanding of what a "combination in restraint of trade" means, then the same monopoly may be attempted and effected by an individual, and is made equally illegal in that case by § 2. But I do not expect to hear it maintained that Mr. Morgan could be sent to prison for buying as many shares as he liked of the Great Northern and the Northern Pacific, even if he bought them both at the same time and got more than half the stock of each road.

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In view of my interpretation of the statute I do not go further into the question of the power of Congress. That has been dealt with by my brother White and I concur, in the main, with his views. I am happy to know that only a minority of my brethren adopt an interpretation of the law which, in my opinion, would make eternal the *bellum omnium contra omnes* and disintegrate society so far as it could into individual atoms. If that were its intent I should regard calling such a law a regulation of commerce as a mere pretence. It would be an attempt to reconstruct society. I am not concerned with the wisdom of such an attempt, but I believe that Congress was not intrusted by the Constitution with the power to make it, and I am deeply persuaded that it has not tried.

Mr. Justice White, with whom concur Mr. Chief Justice Fuller, Mr. Justice Peckham and Mr. Justice Holmes, dissenting:

The Northern Securities Company is a New Jersey corporation; the Great Northern Railway Company, a Minnesota one; and the Northern Pacific Railway Company, a Wisconsin corporation. Whilst in the argument at bar the government referred to the subject, nevertheless it expressly disclaimed predicating any claim for relief upon the fact that the predecessor in title of the Northern Pacific Railway Company was a corporation

created by act of Congress. That fact, therefore, may be eliminated.

The facts essential to be borne in mind to understand my point of view, without going into details, are as follows: the lines of the Northern Pacific and the Great Northern Railway Companies are both transcontinental, that is, trunk lines to the Pacific Ocean, — and in some aspects are conceded to be competing. Mr. Morgan and Mr. Hill and a few persons immediately associated with them separately acquired and owned capital stock of the Northern Pacific Railway Company, aggregating a majority thereof. Mr. Hill and others associated with him owned, in the same manner, about one-third of the capital stock of the Great Northern Railway Company, the balance of the stock being distributed among about eighteen hundred stockholders. Although Mr. Hill and his immediate associates owned only one-third of the stock the confidence reposed in Mr. Hill was such that, through proxies, his influence was dominant in the affairs of that company. Under these circumstances Mr. Morgan and Mr. Hill organized under the laws of New Jersey the Northern Securities Company. The purpose was that the company should become the holder of the stock of the two railroads. This was to be effected by having the Northern Securities Company give its stock in exchange for that of the two railroad companies. Whilst the purpose of the promoters was mainly to exchange the stock held by them in the two railroads for the Northern Securities Company stock, nevertheless the right of stockholders generally in the two railroads to make a similar exchange or to sell their stock to the Securities Company was provided for. Under the arrangement the Northern Securities Company came to be the registered holder of a majority of the stock of both the railroads. It is not denied that the charter and the acts done under it, of the Northern Securities Company, were authorized by the laws of New Jersey, and, therefore, in so far as those laws were competent to sanction the transaction, the corporation held the stock in the two railroads secured by the law of the state of its domicil.

The government by its bill challenges the right of the Northern Securities Company to hold and own the stock in the two

railroads. The grounds upon which the relief sought was based were, generally speaking, as follows: That, as the two railroads were competing lines engaged in part in interstate commerce, the creation of the Northern Securities Company and the acquisition by it of a majority of the stock of both roads was contrary to the act of Congress known as the Anti-Trust Act. 26 Stat. at L., 209, chap. 647, U. S. Comp. Stat. 1901, page 3200. The clauses of the act which it was charged were violated were the first section, declaring illegal "every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several states, or with foreign nations"; and the provisions of the second section, making it a misdemeanor for any person to "monopolize, or attempt to monopolize, or combine or conspire with any other person or persons to monopolize, any part of the trade or commerce among the several states or with foreign nations." The court below sustained the contentions of the government. It, therefore, enjoined the two railroad companies from allowing the Northern Securities Company to vote the stock standing in its name or to pay to that company any dividends upon the stock by it held. On the giving, however, of a bond fixed by the court below the decree relating to the payment of dividends was suspended pending the appeal to this court.

The court recognized, however, the right of the Northern Securities Company to re-transfer the stock in both railroads to the persons from whom it had been acquired. The correctness of the decree below is the question presented for decision.

Two questions arise. Does the Anti-Trust Act, when rightly interpreted, apply to the acquisition and ownership by the Northern Securities Company of the stock in the two railroads? and, second, If it does, had Congress the power to regulate or control such acquisition and ownership? As the question of power lies at the root of the case, I come at once to consider that subject. Before doing so, however, in order to avoid being misled by false or irrelevant issues, it is essential to briefly consider two questions of fact. It is said, first, that the mere exchange by the Northern Securities Company of its stock for stock in the railroads did not make the Northern Securities Company the real

owner of the stock in the railroads, since the effect of the transaction was to cause the Securities company to become merely the custodian or trustee of the stock in the railroads; second, that as the two railroads were both overcapitalized, stock in them furnished no sufficient consideration for the issue of the stock of the Northern Securities Company. It would suffice to point out (*a*), that the proof shows that nearly nine million dollars was paid by the Securities company for a portion of the stock acquired by it, and that, moreover, nearly thirty-five million dollars was expended by the Securities company in the purchase of bonds of the Northern Pacific Company, which have been converted by the Securities company into the stock of that railroad, which the Securities company now holds; and (*b*), that the market value of the railroad stocks is, moreover, indisputably shown by the proof to have been equal to the value fixed on them for the purpose of the exchange or purchase of such stock by the Northern Securities Company. Be this as it may, it is manifest that these considerations can have no possible influence on the question of the power of Congress in the premises; and therefore the suggestions can serve only to obscure the controversy. If the power was in Congress to legislate on the subject it becomes wholly immaterial what was the nature of the consideration paid by the company for the stock by it acquired and held if such acquisition and ownership, even if real, violated the act of Congress. If, on the contrary, the authority of Congress could not embrace the right of the Northern Securities Company to acquire and own the stock, the question of what consideration the Northern Securities Company paid for the stock or the method by which it was transferred must necessarily be beyond the scope of the act of Congress.

In testing the power of Congress I shall proceed upon the assumption that the act of Congress forbids the acquisition of a majority of the stock of two competing railroads engaged in part in interstate commerce by a corporation or any combination of persons.

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The plenary authority of Congress over interstate commerce,

its right to regulate it to the fullest extent, to fix the rates to be charged for the movement of interstate commerce, to legislate concerning the ways and vehicles actually engaged in such traffic, and to exert any and every other power over such commerce which flows from the authority conferred by the Constitution, is thus conceded. But the concessions thus made do not concern the question in this case, which is not the scope of the power of Congress to regulate commerce, but whether the power extends to regulate the ownership of stock in railroads, which is not commerce at all. The confusion which results from failing to observe this distinction will appear from an accurate analysis of *Gibbons* v. *Ogden*, for in that case the great Chief Justice was careful to define the commerce the power to regulate which was conferred upon Congress, and in the passages which I have previously quoted, simply pointed out the rule by which it was to be determined in any case whether Congress, in acting upon the subject, had gone beyond the limits of the power to regulate commerce as it was defined in the opinion. Accepting the test announced in *Gibbons* v. *Ogden* for determining whether a given exercise of the power to regulate commerce has in effect transcended the limits of regulation, it is essential to accept also the luminous definition of commerce announced in that case and approved so many times since, and hence to test the question for decision by that definition. The definition is this: "Commerce undoubtedly is traffic, but it is something more, — it is intercourse. It describes the commercial intercourse between nations and parts of nations in all its branches, *and is regulated by prescribing rules for carrying on that intercourse.*" (Italics mine.)

Does the delegation of authority to Congress to regulate commerce among the states embrace the power to regulate the ownership of stock in state corporations, because such corporations may be in part engaged in interstate commerce? Certainly not, if such question is to be governed by the definition of commerce just quoted from *Gibbons* v. *Ogden*. Let me analyze the definition. "Commerce undoubtedly is traffic, but it is something more, — it is intercourse;" that is, traffic between the states and intercourse between the states. I think the ownership of stock

in a state corporation cannot be said to be in any sense traffic between the states or intercourse between them. The definition continues, " It describes the commercial intercourse between nations and parts of nations." Can the ownership of stock in a state corporation, by the most latitudinarian construction, be embraced by the words "commercial intercourse between nations and parts of nations"? And to remove all doubt, the definition points out the meaning of the delegation of power to regulate, since it says that it is to be "regulated by prescribing rules for carrying on that intercourse." Can it in reason be maintained that to prescribe rules governing the ownership of stock within a state, in a corporation created by it, is within the power to prescribe rules for the regulation of intercourse between citizens of different states?

But if the question be looked at with reference to the powers of the Federal and state governments, — the general nature of the one and the local character of the other which it was the purpose of the Constitution to create and perpetuate, — it seems to me evident that the contention that the authority of the national government under the commerce clause gives the right to Congress to regulate the ownership of stock in railroads chartered by state authority is absolutely destructive of the 10th Amendment to the Constitution, which provides that "the powers not delegated to the United States by the Constitution, nor prohibited by it to the states, are reserved to the states respectively or to the people." This must follow, since the authority of Congress to regulate on the subject can, in reason, alone rest upon the proposition that its power over commerce embraces the right to control the ownership of railroads doing in part an interstate commerce business. But power to control the ownership of all such railroads would necessarily embrace their organization. Hence it would result that it would be in the power of Congress to abrogate every such railroad charter granted by the states from the beginning if Congress deemed that the rights conferred by such state charters tended to restrain commerce between the states or to create a monopoly concerning the same.

Besides, if the principle be acceded to it must in reason be

held to embrace every consolidation of state railroads which may do in part an interstate commerce business, even although such consolidation may have been expressly authorized by the laws of the states creating the corporations.

It would likewise overthrow every state law forbidding such consolidations; for if the ownership of stock in state corporations be within the regulating power of Congress under the commerce clause, and can be prohibited by Congress, it would be within the power of that body to permit that which it had the right to prohibit.

But the principle that the ownership of property is embraced within the power of Congress to regulate commerce, whenever that body deems that a particular character of ownership, if allowed to continue, may restrain commerce between the states or create a monopoly thereof, is, in my opinion, in conflict with the most elementary conceptions of rights of property. For it would follow if Congress deemed that the acquisition by one or more individuals engaged in interstate commerce of more than a certain amount of property would be prejudicial to interstate commerce, the amount of property held or the amount which could be employed in interstate commerce could be regulated.

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It is said, moreover, that the decision of this case does not involve the consequences above pointed out since the only issue in this case is the right of the Northern Securities Company to acquire and own the stock. The right of that company to do so, it is argued, is one thing; the power of individuals or corporations, when not merely organized to hold stock, an entirely different thing. My mind fails to seize the distinction. The only premise by which the power of Congress can be extended to the subject-matter of the right of the Securities company to own the stock must be the proposition that such ownership is within the legislative power of Congress, and if that proposition be admitted it is not perceived by what process of reasoning power of Congress over the subject-matter of ownership is to be limited to ownership by particular classes of corporations or persons. If the power embraces ownership, then the authority of

Congress over all ownership which, in its judgment, may affect interstate commerce, necessarily exists. In other words, the logical result of the asserted distinction amounts to one of two things: Either that nothing is decided, or that a decree is to be entered having no foundation upon which to rest. This is said because, if the control of the ownership of stock in competing roads by one and the same corporation is within the power of Congress, and creates a restraint of trade or monopoly forbidden by Congress, it is not conceivable to me how exactly similar ownership by one or more individuals would not create the same restraint or monopoly, and be equally within the prohibition which it is decided Congress has imposed. Besides the incongruity of the conclusion, resulting from the alleged distinction, to admit it would do violence to both the letter and spirit of the Constitution; since it would in effect hold that, although a particular act was a burden upon interstate commerce or a monopoly thereof, that individuals could lawfully do the act, provided only they did not use the instrumentality of a corporation. But this court long since declared that the power to regulate commerce, conferred upon Congress, was "general and includes alike commerce by individuals, partnerships, associations and corporations." *Paul* v. *Virginia*, 8 Wall., 168, 183, 19 L. ed., 357, 361.

Indeed, the natural reluctance of the mind to follow an erroneous principle to its necessary conclusion, and thus to give effect to a grievous wrong arising from the erroneous principle, is an admonition that the principle itself is wrong. That admonition, I submit, is conclusively afforded by the decree which is now affirmed. Without stopping to point out what seems to me to be the confusion, contradiction and denial of rights of property which the decree exemplifies, let me see if, in effect, it is not at war with itself and in conflict with the principle upon which it is assumed to be based.

Fundamentally considered, the evil sought to be remedied is the restraint of interstate commerce and the monopoly thereof, alleged to have been brought about through the acquisition by Mr. Morgan and Mr. Hill and their friends and associates, of a controlling interest in the stock of both the roads. And yet the decree, whilst forbidding the use of the stock by the Northern

Securities Company, authorizes its return to the alleged conspirators, and does not restrain them from exercising the control resulting from the ownership. If the conspiracy and combination existed and was illegal, my mind fails to perceive why it should be left to produce its full force and effect in the hands of the individuals by whom it was charged the conspiracy was entered into.

It may, however, be said that even if the results which I have indicated be held necessarily to arise from the principles contended for by the government, it does not follow that such power would ever be exerted by Congress, or, if exerted, would be enforced to the detriment of charters granted by the states to railroads or consolidations thereof, effected under state authority, or the ownership of stock in such railroads by individuals, or the rights of individuals to acquire property by purchase, lease or otherwise, and to make any and all contracts concerning property which may thereafter become the subject-matter of interstate commerce. The first suggestion is at once met by the consideration that it has been decided by this court that, as the Anti-Trust Act forbids any restraint, it therefore embraces even reasonable contracts or agreements. If, then, the ownership of the stock of the two railroads by the Northern Securities Company is repugnant to the act, it follows that ownership, whether by the individual or another corporation, would be equally within the prohibitions of the act. As to the second, true it is that by the terms of the Anti-Trust Act the power to put its provisions in motion is, as to many particulars, confided to the highest law officer of the government; and if that officer did not invoke the aid of the courts to restrain the rights of the railroads previously chartered by the states to enjoy the benefits conferred upon them by state legislation, or to prevent individuals from exercising their right of ownership and contract, the law in these respects would remain a dead letter. But to indulge in this assumption would be but to say that the law would not be enforced by the highest law officer of the government, — a conclusion which, of course, could not be indulged in for a moment. In any view, such suggestion but involves the proposition that vast rights of property, instead of resting upon con-

stitutional and legal sanction, must alone depend upon whether an executive officer might elect to enforce the law, — a conclusion repugnant to every principle of liberty and justice.

Having thus by the light of reason sought to show the unsoundness of the proposition that the power of Congress to regulate commerce extends to controlling the acquisition and ownership of stock in state corporations, railroad or otherwise, because they may be doing an interstate commerce business, or to the consolidation of such companies under the sanction of state legislation, or to the right of the citizen to enjoy his freedom of contract and ownership, let me now endeavor to show, by a review of the practices of the governments, both state and national, from the beginning, and the adjudications of this court, how wanting in merit is the proposition contended for. It may not be doubted that from the foundation of the government, at all events to the time of the adoption of the Anti-Trust Act in 1890, there was an entire absence of any legislation by Congress even suggesting that it was deemed by any one that power was possessed by Congress to control the ownership of stock in railroad or other corporations because such corporations engaged in interstate commerce. On the contrary, when Congress came to exert its authority to regulate interstate commerce as carried on by railroads, manifested by the adoption of the Interstate Commerce Act (24 Stat. at L., 379, chap. 104, U. S. Comp. Stat. 1901, page 3154), it sedulously confined the provisions of that act to the carrying on of interstate commerce itself, including the reasonableness of the rates to be charged for carrying on such commerce and other matters undeniably concerning the fact of interstate commerce. The same conception was manifested subsequently in legislation concerning safety appliances to be used by railroads, since the provisions of the act were confined to such appliances when actually employed in the business of interstate commerce. 27 Stat. at L., 531, chap. 196, U. S. Comp. Stat. 1901, page 3174. It also may not be doubted that from the beginning the various states of the Union have treated the incorporation and organization of railroad companies and the ownership of stock therein as matters within their exclusive authority. Under this conception of power in the states, universally pre-

vailing and always acted upon, the entire railroad system of the United States has been built up. Charters, leases and consolidations under the sanction of state laws lie at the basis of that enormous sum of property and those vast interests represented by the railroads of the United States. Extracts from the reports of the Interstate Commerce Commission and from a standard authority on the subject, which were received in evidence, demonstrate that in effect nearly every great railroad system in the United States is the result of the consolidation and unification of various roads, often competitive, such consolidation or unification of management having been brought about in every conceivable form, sometimes by lease under state authority, sometimes by such leases made where there was no prohibition against them, and by stock acquisitions made by persons or corporations in order to acquire a controlling interest in both roads. Without stopping to recite details on the subject, I content myself with merely mentioning a few of the instances where great systems of railroad have been formed by the unification of the management of competitive roads, by consolidation or otherwise, often by statutory authority. These instances embrace the Boston & Maine system, the New York, New Haven & Hartford, the New York Central, the Reading and the Pennsylvania systems. One of the illustrations—as to the New York Central system — is the case of the Hudson River Railroad on one side of the Hudson River and the West Shore Railroad on the other, — both parallel roads and directly competitive, and both united in one management by authority of a legislative act. It is indeed remarkable, if the whole subject was within the paramount power of Congress, and not within the authority of the states, that there should have been a universal understanding to the contrary from the beginning. When it is borne in mind that such universal action related to interests of the most vital character, involving property of enormous amount, concerning the welfare of the whole people, it is impossible in reason to deny the soundness of the assumption that it was the universal conviction that the states, and not Congress, had control of the subject-matter of the organization and ownership of railroads created by the states. And the same inference is applicable to the condition of things

which has existed since the adoption of the Anti-Trust Act in 1890. Who can deny that from that date to this, consolidations and unification of management, by means of leases, stock ownership by individuals or corporations, have been carried on, when not prohibited by state laws, to a vast extent and that during all this time, despite the energy of the government in invoking the anti-trust law, that no assertion of power in Congress under that act to control the ownership of stock was ever knowingly made until first asserted in this cause. Quite recently Congress has amended the Interstate Commerce Act by provisions deemed essential to make its prohibitions more practically operative, and yet no one of such provisions lend themselves even to the inference that it was deemed by any one that the power of Congress extended to the control of stock ownership. Certainly the states have not so considered it. As a matter of public history it is to be observed that not long since, by authority of the legislature of the state of Massachusetts, a controlling interest by lease of the Boston & Albany road passed to the New York Central system.

The decisions of this court to my mind leave no room for doubt on the subject. As I have already shown, the very definition of the power to regulate commerce, as announced in *Gibbons* v. *Ogden*, excludes the conception that it extends to stock ownership. I shall not stop to review a multitude of decisions of this court concerning interstate commerce, which, whilst upholding the paramount authority of Congress over that subject, at the same time treated it as elementary that the effect of the power over commerce between the states was not to deprive the states of their right to legislate concerning the ownership of property of every character or to create railroad corporations and to endow them with such powers as were deemed appropriate, or to deprive the individual of his freedom to acquire, own and enjoy property by descent, contract or otherwise, because railroads or other property might become the subject of interstate commerce.

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Now, it is submitted, that the decided cases just reviewed

demonstrate that the acquisition and ownership of stock in competing railroads, organized under state law, by several persons or by corporations, is not interstate commerce, and, therefore, not subject to the control of Congress. It is, indeed, suggested that the cases establish a contrary doctrine. This is sought to be demonstrated by quoting passages from the opinions separated from their context, apart from the questions which the cases involved. But as the issues which were decided in the Knight, in the Pearsall, in the Louisville & Nashville case and in the Hopkins case directly exclude the significance attributed to the passages from the opinions in those cases relied upon, it must follow that if such passages could, when separated from their context, have the meaning attributed to them the expressions would be mere *obiter*. And this consideration renders it unnecessary for me to analyze the passages to show that when they are read in connection with their context they have not the meaning now sought to be attached to them. But other considerations equally render it unnecessary to particularly review the sentences relied upon. There can be no doubt that it was expressly decided in the Knight case that the acquisition of stock by one corporation in other corporations so as to control them all was not interstate commerce, *although the goods of the manufacturing companies whose stock was acquired might become the subject of interstate commerce*. If, then, the passage from the Knight case could be given the meaning sought to be affixed to it, the result would be but to say that that case overruled itself. And this would be the result in the Pearsall case, since in that case it was decided that the states had the power to forbid the consolidation of competing railroads, even by means of the acquisition of stock. Besides, as in the Louisville & Nashville case, immediately following the Pearsall, it was expressly decided that the interstate commerce power of Congress did not embrace such consolidation, and Congress, therefore, could not restrain a state from either forbidding or permitting it to take place, it would follow that if the sentences in the Pearsall case had the import now applied to them, that that case not only overruled itself, but was besides overruled by the Louisville & Nashville case, and this although the two cases were decided on

the same day, the opinions in both cases having been delivered by the same justice.

The same confusion and contradiction arises from separating from their context and citing as applicable to this case passages from the opinions in the Freight Association and Joint Traffic cases. Those cases, as I have previously stated, related exclusively to a contract admittedly involving interstate commerce, and it was decided that any restraint of such commerce was forbidden by the Anti-Trust Act. Now, in the Hopkins case, decided subsequent to the Freight Association and Joint Traffic cases, the contract considered unquestionably involved a restraint, but, as such restraint did not concern interstate commerce, it was held not to come within the power of Congress. It would follow then, if the sentences quoted from the opinions in the Freight Association and Joint Traffic cases, which cases concerned only that which was completely interstate commerce, applied to that which was not such commerce, that the Hopkins case overruled both these cases, although the opinions in all of the cases were delivered by the same justice, and no intimation was suggested of such overruling. It would also result that, after having overruled those cases in the Hopkins case, the court, in expressing its opinion through the same justice, proceeded in the Addyston Pipe case, which related only to interstate commerce, to overrule the Hopkins case and reaffirm the prior cases.

Of course, in my opinion, there is no ground for holding that the decided cases embody such extreme contradictions or produce such utter confusion. The cases are all consistent, if only the elementary distinction upon which they proceeded be not obscured, — that is, the difference which arises from the power of Congress to regulate interstate commerce, on the one hand, and its want of authority, on the other, to regulate that which is not interstate commerce. Indeed, the confounding and treating as one, things which are wholly different, is the error permeating all the contentions for the government.

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The fallacy of all the contentions of the government is, to my mind, illustrated by the summing up of the case for the govern-

ment made in the argument at bar. The right to acquire and own the stock of competing railroads involves, says that summing up, the power of an individual "*to do*" (italics mine) absolutely as he pleases with his own, whilst the claim of the government is that the right of the owner of property "*to do*" (italics mine) as he pleases with his own may be controlled in the public interest by legitimate legislation. But the case involves the right to *acquire and own*, not the right "*to do*" (italics mine). Confusing the two gives rise to the errors which it has been my endeavor to point out. Undoubtedly the states possess power over corporations created by them, to permit or forbid consolidation, whether accomplished by stock ownership or otherwise, to forbid one corporation from holding stock in another, and to impose on this or other subjects such regulations as may be deemed best. Generally speaking, however, the right to do these things springs alone from the fact that the corporation is created by the state, and holds its rights subject to the conditions attached to the grant, or to such regulations as the creator, the state, may lawfully impose upon its creature, the corporation. Moreover, irrespective of the relation of creator and creature, it is, of course, true in a general sense that government possesses the authority to regulate, within certain just limits, what an owner *may do* with his property. But the first power which arises from the authority of a grantor to exact conditions in making a grant or to regulate the conduct of the grantee gives no sanction to the proposition that a government, irrespective of its power to grant, has the general authority to limit the character and quantity of property which may be acquired and owned. And the second power, the general governmental one, to reasonably control the *use* of property, affords no foundation for the proposition that there exists in government a power to limit the quantity and character of property which may be acquired and owned. The difference between the two is that which exists between a free and constitutional government, restrained by law, an absolute government, unrestrained by any of the principles which are necessary for the perpetuation of society, and the protection of life, liberty and property.

It cannot be denied that the sum of all just governmental

power was enjoyed by the states and the people before the Constitution of the United States was formed. None of that power was abridged by that instrument except as restrained by constitutional safeguards, and hence none was lost by the adoption of the Constitution. The Constitution, whilst distributing the preexisting authority, preserved it all. With the full power of the states over corporations created by them and with their authority in respect to local legislation, and with power in Congress over interstate commerce carried to its fullest degree, I cannot conceive that if these powers, admittedly possessed by both, be fully exerted, a remedy cannot be provided fully adequate to suppress evils which may arise from combinations deemed to be injurious. This must be true unless it be concluded that, by the effect of the mere distribution of power made by the Constitution, partial impotency of governmental authority has resulted. But if this be conceded, *arguendo*, the Constitution itself has pointed out the method by which, if changes are needed, they may be brought about. No remedy, in my opinion, for any supposed or real infirmity, can be afforded by disregarding the Constitution, by destroying the lines which separate state and Federal authority, and by implying the existence of a power which is repugnant to all those fundamental rights of life, liberty and property upon which just government must rest.

If, however, the question of the power of Congress be conceded, and the assumption as to the meaning of the Anti-Trust Act which has been indulged in for the purpose of considering that power be put out of view, it would yet remain to be determined whether the Anti-Trust Act embraced the acquisition and ownership of the stock in question by the Northern Securities Company. It is unnecessary for me, however, to state the reasons which have led me to the conclusion that the act, when properly interpreted, does not embrace the acquisition and ownership of such stock, since that subject is considered in an opinion of Mr. Justice Holmes, which explains the true interpretation of the statute, as it is understood by me, more clearly than I would be able to do.

Being of the opinion, for the reasons heretofore given, that Congress was without power to regulate the acquisition and

ownership of the stock in question by the Northern Securities Company, and because I think even if there were such power in Congress, it has not been exercised by the Anti-Trust Act, as is shown in the opinion of Mr. Justice Holmes, I dissent.

I am authorized to say that the Chief Justice, Mr. Justice Peckham, and Mr. Justice Holmes concur in this dissent.

After this disapproval of the merger, by the Supreme Court, it became necessary to dissolve the company. The Morgan-Hill party in control proceeded to divide the assets of the company pro rata among the owners. The practical result would have been that a majority of the stock of the Northern Pacific Co. would have remained in the hands of the Great Northern's owners. To this plan the Harriman interests, representing the Union and Southern Pacific Companies, objected, demanding the return of the same securities, with control of the Northern Pacific, which they had turned in originally, after having secured such control in May, 1901. An injunction against the Morgan-Hill plan of dissolution was obtained on July 15, 1904. This injunction was dissolved in favor of the Hill party by the Federal Appellate Court, Jan. 4, 1905, and now goes to the Supreme Court for final decision. Upon this decision the question of final control of the Northern Pacific Railroad by its transcontinental rivals depends. — ED.

XV

THE MASSACHUSETTS BUSINESS CORPORATION LAW[1]

THE Massachusetts Business Corporation Law, enacted by the legislature of 1903, has been the subject of discussion and criticism by no means limited to the state. The charge has been made that in the enactment of this code the conservative state of Massachusetts has at last surrendered to the demands of promoters, and has joined the states which vie with each other in bidding for the privilege of giving charters to irresponsible corporations. It is the purpose of this article first very briefly to point out the causes leading to the enactment of a new corporation law in Massachusetts, and then to discuss those features of the law which distinguish it from the more recently enacted corporation laws of other states and to indicate its probable influence upon the organization and legislative regulation of industrial corporations.

The fundamental reason for the enactment of the new law is to be found in the defects of the previous legislation of the state relating to business corporations. The groundwork of this legislation had survived nearly a hundred years since the earliest legislative regulation of such forms of organization. Successive amendments permitting incorporation without special act of the legislature, the payment of stock in property as well as in cash, and finally, as to certain classes of corporations, an unlimited capitalization, were obvious concessions to the demands of developing business methods. These amendments left the law, however, in form a mere patchwork, and in substance neither a real protection to stockholders or investors nor sufficiently liberal in some respects to attract the incorporation

[1] From the *Quarterly Journal of Economics*, Vol. XVIII, 1904, pp. 269–280.

of business enterprises organized and financed in the state. During the past five years the advantages offered by the more liberal corporation laws of other states have been availed of to a constantly increasing extent until in the year 1901 two business corporations were organized under a foreign charter for the purpose of doing business in Massachusetts for every such corporation organized under the laws of the state.

Business men felt a certain degree of resentment in being advised to organize their corporations outside of their own state, and a movement was set on foot in the early months of 1902 to secure, if possible, some relief. Under a legislative resolve passed in that year, Governor Crane appointed a special committee on Corporation Laws, which, after many public hearings and a very careful investigation of the subject, reported to the legislature in January, 1903, the draft of a Business Corporation Law which was subsequently enacted without substantial amendment, with the exception of one provision relating to taxation.

It was the avowed purpose of the special committee, upon which much of the responsibility for this new law must rest, to draft a law which would permit, under conditions generally as favorable as could be secured under a foreign charter, the incorporation under Massachusetts laws of business enterprises financed by Massachusetts capital. The new law certainly was not designed to increase the revenues of the state. Under the old law Massachusetts collected from both business and public service corporations a larger franchise tax for the year 1901 than was collected in that year from the same source by any other state except New York and New Jersey.[1] It can be stated with

[1] The amounts received in 1901 from the taxation of corporate franchises of business and public service corporations, as reported by the Massachusetts Committee on Corporation Laws, Report, pp. 299–303, are the following:

New York	$4,966,680.93
New Jersey	1,633,074.19
Massachusetts *	1,271,316.23
Pennsylvania	1,005,184.23
West Virginia	322,078.50
Maine	39,225.00

* The receipts from business corporations reported by the Committee on Corporation Laws were $331,434.38. The balance represents receipts from public service and other corporations reported by the Tax Commissioner. Report, 1901, p. 8.

equal positiveness that it was not the intention of the framers of the new law to place Massachusetts in the position of being a competitive rival for the business of incorporating enterprises financed and doing business exclusively outside of the state, or of drafting a law "which will be favorable to the organization of large corporations popularly known as trusts." [1] How far Massachusetts has succeeded in adopting a corporation code which, on the one hand, will attract the incorporation of the legitimate business enterprises in which its citizens are interested, whether designed to do business within or without the state, and yet will discourage the organization of inflated promotion schemes and adequately protect both the stockholder and creditor, can best be determined after considering in some detail those provisions of the new law which are particularly designed to accomplish these ends.

Although the subject of the taxation of corporations occupied by far the largest share of the consideration of the special committee, the recommended changes in the existing law are few in number. The existing theory, of a tax levied by the state indirectly upon the stockholder on the market value of his stock, has been retained, not because the theory upon principle commended itself especially to the committee, but for the practical reason that any other rule which could logically be adopted would very largely increase the amount of taxes paid by more than half of the existing Massachusetts corporations. The committee so amended the former laws relating to taxation as to enable the organization of Massachusetts corporations for the purpose of doing business outside of the state without being subject to undue taxation, and also to make possible the organization of corporations to hold the securities of Massachusetts companies. The legislature added a limitation of the maximum value of the taxable corporate franchise to an amount not exceeding 120 per cent of the actual value of the tangible assets of the corporation. While this amendment will reduce somewhat in the first instance the revenue of the state from its corporations, it was believed to be necessary in order to retain in the state some of the most successful corporations, and to attract business

[1] Report of Committee on Corporation Laws, pp. 24 and 61

enterprises which otherwise might hesitate to incorporate under a Massachusetts charter for fear of the operation of an unlimited tax upon that portion of the value of their capital stock representing intangible assets. The provisions of the new law relating to taxation are, therefore, a reenactment of the former laws, with amendments which will prevent double taxation and place Massachusetts as nearly as possible on a basis of equality with other states in this particular.

Corporations organized under the Business Corporation Law are permitted the largest degree of freedom in conducting their business consistent with a sufficient protection of the interests of minority stockholders. All corporate action can be taken upon the affirmative vote of a majority in interest of the stockholders, except such action as may affect the value of the stock. It should be noted, however, that the creation of a new class of stock, or the sale, lease or exchange of all of the property of the corporation, requires the concurrent vote of two-thirds of its stockholders. At organization almost any scheme regulating the classification, powers and voting rights of the stock of the company may be lawfully adopted. The stockholders' and directors' liabilities are reduced to correspond in the main with those prevailing in most of the other states. The requirements of the former law relating to the annual filing of certificates of condition by domestic and foreign corporations have been retained. The machinery by which stockholders may secure information as to the doings of the corporation has been made more effective. It was the purpose of the committee to draft a law in this particular which would enable any stockholder who, in good faith, desired information, to secure it without delay or unnecessary expense, while, on the other hand, the law would protect the corporation from inquisitive annoyance, instigated perhaps by hostile motives.

In relation to foreign corporations, Massachusetts has followed the lead of several of the Western states in attempting to place upon an equal basis, so far as possible, the corporations organized under its own laws and those organized under foreign charters. Rather as a means of demanding recognition than for the purpose of securing a larger amount of revenue, an excise

tax has been imposed upon foreign corporations. As this tax amounts to only one-hundredth of one per cent upon the authorized capitalization, and as corporations are permitted to deduct from this amount whatever taxes are locally paid by them, the tax will practically affect those corporations only which under the old law conducted their business in whole or in part in the state without directly paying any tax whatever in return for the privilege which the state as a matter of comity extended to them. As the maximum tax to be paid is limited to two thousand dollars, it is not expected that even the larger industrial corporations will be deterred from doing business in the state. It is believed that with the imposition of this nominal excise tax will come an increased degree of responsibility from the state towards foreign corporations; and, inasmuch as no action can be maintained in its courts by foreign corporations until this tax is paid and the annual certificate of condition filed, it is hoped that the new law will inspire a greater respect for the legislative requirements of the state than has been evinced during the past few years by such corporations.

From an economic point of view these features of the Business Corporation Law are overshadowed in interest by its provisions relating to the issue and payment of capital stock. The attacks which have been made upon the new law have been focussed upon the fact that it permits the unlimited capitalization of intangible assets, — "wind and water" is the more popular expression among the critics of the law. It may, then, be profitable to consider this provision of the new law in some detail.

Logically there are the three following theories upon which statutory provisions relating to the payment of capital stock by property conveyed to the corporation can be based:

1. That the incorporators are the judges of the value of property to be conveyed to the corporation in payment of stock, and that the state has no interest or duty in the matter except to create a liability for fraudulent action. This is the most generally accepted theory of the more recently enacted corporation laws in this country.

On this theory, in the absence of actual fraud, the judgment

of the directors is conclusive. Even if fraud can be proved, which has only rarely been accomplished, the title to the stock in question cannot be attacked; and the only remedy is a personal one against the fraudulent directors. The practice, so widely advertised in connection with the receivership proceedings of the United States Shipbuilding Company, of electing irresponsible dummies to protect the parties to fraudulent proceedings from any danger of personal liability, is by no means unusual. The most obvious defect in this legislation is that the facts concerning the issue of stock for property are hidden in the records of proceedings of the board of directors to which the stockholder or prospective investor has no access. He is unable to form an independent judgment as to the value of the property of which his stock represents a fractional interest. He is guided in making his investment solely by the more or less misleading statements contained in a prospectus and by the equally fictitious quotations which manipulation in the stock market can give to such securities when issued and listed on a stock exchange.

2. The second theory relating to the payment of capital stock in property is that the issue of stock so paid for must be controlled and limited by the state. This theory has been logically adopted in the existing legislation in Massachusetts, so generally and justly commended, relating to the issue of securities by public service corporations. It has been asserted that it governed also the issue of stock of business corporations under the law now repealed by the Business Corporation Law. But this assertion would not be made by any one familiar with its administration.

The earlier law provided that capital stock might be issued for property to the extent sanctioned by the Commissioner of Corporations. The commissioner soon found it necessary to establish certain rules in regard to this subject. One was that no stock could be issued for patent rights or other intangible interests. This rule was conservative, and worked substantial justice in a majority of cases. In some instances, however, patent rights have proved to be very substantial assets from the point of view of the investments which they represent and the

dividends which they can earn. In at least one case a well-established business in Massachusetts was compelled to secure a special act of incorporation from the legislature in order to make possible a partial capitalization of its very valuable good will

As the statute provided no machinery, and as no appropriation was allowed, for securing a fair appraisal of the tangible property to be conveyed to the corporation in payment of its stock, the Commissioner of Corporations has always required a sworn statement to be made as to the value of property for which it is proposed to issue stock. This statement has been accepted by the commissioner, in the absence of further information, as a basis of his appraisal. The practical effect of this practice has been to enable incorporators to fix their own valuation of property for which stock is issued, as is the almost universal rule in other states. That the former law was unsuccessful in guaranteeing the success of corporations organized under its provisions is well indicated by the fact, as the writer has been informed, that nearly 75 per cent of the corporations which have been reported insolvent to the United States courts for the district of Massachusetts during the past three years have been organized under laws of that state. It may fairly be said, therefore, that under the former law the state in attempting to be sponsor for the solvency of private corporations organized under its provisions failed signally to accomplish the intended results. There can be no middle way. The state must either undertake an examination by its own experts of the value of the prospective assets of the corporation or it must not pretend to do anything of the kind.

There is much to be said in favor of such an appraisal in the case of public service corporations. The state has granted valuable franchises, and in many cases protects the corporation from disastrous competition. It may well be argued that in return it is the duty of the state to see to it that these franchises are not sold to the investing public at an unfair valuation. There is no such reason for protecting the investors in business corporations where competition is unlimited and the only right given by the state is the right of existence. In this class of corporations the state cannot afford to undertake for the benefit

of prospective investors — many of whom, perhaps, are not its citizens — an appraisal for which it will be held responsible. If all the facts necessary to enable individual investors to exercise their own judgment as to the value of the securities of private corporations are required and enforced by suitable legislation, the state has done all that can be required of it.

3. The third theory, and the one adopted in the new Massachusetts law in regard to the duties of the state in regulating the issue of stock for property, is that, so long as incorporators are not acting fraudulently, they may capitalize any property, tangible or intangible, at any amount they desire, provided that no stock may be issued at or after organization until a statement has been prepared and placed upon public record, showing the amount of stock which has been issued and the exact manner in which it is paid for. If the payment is in cash, the facts will be so stated; if in property, a description of the same must be included in the statement, which will be sufficient for purposes of identification; if stock is to be issued for services or expenses, their nature or extent must be set forth. On this theory prospective stockholders and creditors deal with the corporation at their own peril. The state does not assume either to give its sanction to a "blind pool," as it may be said to do under the first theory mentioned, or to guarantee, directly or indirectly, the value of the property for which capital stock is issued, as it may be said to have done under the former law.

Publicity,[1] therefore, and not paternalism, is now adopted in Massachusetts as its remedy for the evil of overcapitalization. A public statement sufficient to acquaint prospective stockholders with the facts concerning the property of which they may become part owners is, under the new law, a condition precedent to the legality of stock issued. Directors are liable, as in other states and as they were liable under the former law in Massachusetts, for making statements which they know to be false. This protection, however, is merely secondary. If investors and speculators purchase, or make advance payments on a speculative

[1] Concerning publicity as a remedy for these and other evils in the corporation problem, consult the provisions of the English and German statutes herein described. — ED.

purchase by a broker, of a fractional interest in property which is described to them with sufficient detail for purposes of identification, they have themselves to blame if they pay too high a price for it. And when the investor has thoroughly learned his lesson, which can only be taught by experience, he will be able, with the assistance of legislation based upon the theory now adopted by Massachusetts, to make a search of the facts relating to the value of stock in which he is interested, with much of the same thoroughness which he now shows in examining the title to real estate.

At least for the present, the affirmative requirements of the new law relating to publicity, both in regard to the payment of capital and in the matter of annual statements of financial condition, will probably deter the incorporation in Massachusetts of the larger industrial organizations. The practical prohibition against the organization of corporations to hold securities other than those of Massachusetts companies, while not primarily designed for this purpose, is another very practical reason why the very large industrial corporations will continue to organize outside of that state. Finally, the requirement of the minimum state corporate tax of one-tenth of one per cent of authorized capital, without allowing, as is the practice in many of the so-called "corporation states," very large deductions for enterprises of large capitalization, in itself is sufficient to discourage the organization of such corporations. It was estimated by the special committee[1] that the United States Steel Corporation would, under this provision of the Massachusetts law, pay an annual tax of over six hundred thousand dollars as compared with its present annual tax in New Jersey of less than sixty thousand dollars.

The effect of the new law in attracting the incorporation of new companies and upon the revenues of the state cannot be definitely determined until it has been in effect for at least a year. The results already shown are gratifying to its friends. The following table indicates the number and the total capitalization of corporations organized under the Business Corporation Law from August 1 to November 1, 1903, with the amount received

[1] Report of Committee on Corporation Laws, p. 63.

by the state for organization fees.[1] The figures for the corresponding period in 1902 are also given as a basis of comparison:

Year	Number of Corporations	Total Capitalization	Fees
1902	44	$1,015,800	$550 00
1903	200	$12,481,100	$3,953.73

Of the newly organized corporations, one is capitalized for $1,500,000, one for $800,000, four with a capital of $500,000, six with a capital of $250,000, and the remaining ranging down to the minimum of $1000. In November an industrial corporation was incorporated with a capitalization of $5,900,000 to take over, under a plan of reorganization, the assets of a large industrial business operating chiefly in Massachusetts, formerly incorporated with a larger capitalization under the laws of New Jersey.

These figures show that the new law has already become acceptable to the organizers of the smaller partnership corporations. That more corporations with a larger capitalization have not already been organized is not surprising in view of prevailing financial conditions and the probable unfamiliarity of the business interests of the state with all of the advantages of the new law.

It will probably never be possible to enact a corporation law which will entirely solve the problem of giving sufficient freedom to the promoters of the enterprise, adequate protection to its

[1] Later data are confirmatory as follows. — Ed.

	Number of Corporations	Capitalization of Corporations
Old Law. August 1, 1902, to August 1, 1903 . . .	257	$11,590,460
New Law. August 1, 1903, to August 1, 1904 . . .	1000	$66,623,610

stockholders, and an equitable tax to the state which is responsible for its creation. It certainly will not be possible to frame such a code in this country until a national law can constitutionally be enacted. In emphasizing the necessity of publicity in relation to the question of capitalization, and the opportunities of regulation by taxation, in the case of foreign corporations, Massachusetts has, by the enactment of its Business Corporation Law, at least pointed the way which must be followed in future legislation.

GROSVENOR CALKINS.

XVI

THE PROMOTION OF COMPANIES AND THE VALUATION OF ASSETS ACCORDING TO GERMAN LAW[1]

GERMAN Company Law was entirely changed and recast by a statute passed in 1884, which introduced a number of checks and restrictions of an entirely novel character. Many fears were expressed at the time. All enterprise was to be hampered in the future and driven to foreign countries. No persons of means and standing were to be found who would incur the liabilities and risks to which directors and promoters were to be subject under the new state of things. Sufficient time has now elapsed to show that the forecast of these prophets of evil was based on misapprehension. The statistics prove conclusively that the formation of new companies, far from being arrested by the greater stringency of the law, has been progressing in a most remarkable manner, and that the career of German companies has, on the whole, been most prosperous.[2] Some of the new

[1] From the *Economic Journal*, Vol. X, 1900, pp. 1–19. See Ring, Aktiengesetz, 2d ed., Berlin, 1892; Pinner, Das Deutsche Aktienrecht, Berlin, 1899; Esser, Die Aktiengesellschaft, Berlin, 1899; Riesser, Die Neuerungen im Deutschen Aktienrecht, Berlin, 1899.

[2] There were in Germany in 1896 according to Professor R. van der Borght's estimate (Conrad's Handwörterbuch, Vol. I, 2d ed., pp. 192–194) 3712 companies limited by shares with a total paid-up capital of over £340,000,000, and with reserve funds amounting all together to £58,000,000; the annual net earnings of 3249 companies amounted to about £32,400,000, or about 10 per cent of the paid-up capital It is safe to assume from the figures given that not less than one-half of the total number of these companies were formed after the Act of 1884. In the blue book published by the departmental committee of the Board of Trade in 1895 (7779) a letter is quoted from Mr. Geib of the British Consulate General at Berlin estimating the total paid-up capital at £200,000,000 (see p. 29). I showed at the time (see p 30) that the capital must be at least £300,000,000, and the statistics given in the text prove conclusively that Mr. Geib's estimate was still further from the truth than I suspected.

safeguards have not proved quite as efficient as was expected by the legislature, but the net result has been a clear gain. There are good grounds for saying that dishonest or even reckless company promotion is no longer known in Germany. No doubt commercial and industrious enterprise in that country has lately passed through a period of prosperity, which cannot be expected to continue unchecked; but times of prosperity, as a general rule, facilitate the task of unscrupulous financiers, and the absence of unsound company promotion in such times may be accepted as satisfactory proof of the efficiency of the law.

The statute on stock-exchange and produce-exchange transactions passed by the German Reichstag in 1896, though laying down certain restrictions as to dealings in shares on the stock exchanges, does not touch the law on the formation and management of companies. The imperial commission on whose recommendation that statute was prepared[1] accepted the testimony of experts on all sorts of matters, however remotely connected with the subject of their inquiry, and would no doubt have listened to any complaints that might have been made as to the efficiency of the law of 1884. The fact that no such criticism came forward is good negative evidence of the non-existence of any substantial grounds of dissatisfaction.

Another opportunity for complaints against the efficiency of the Act of 1884 was given by the inquiries of the committee appointed to assist in the revision of the German mercantile code, but in this case also the only points referred to were matters of detail not affecting the main principles of the law. The amendments which were introduced into the new mercantile code in connection with company law are not without importance, but they are all in the direction of strengthening the principles laid down in 1884.

Company law can be looked upon from three different points of view: the shareholders' point of view, the creditors' point of view, and the point of view of the general public. If the shareholders' point of view was the only one to be considered, much might be said in favor of abstention from legislative inter-

[1] The reports and minutes of the sittings of this commission have been published and contain much interesting information.

ference. There is no reason why persons who invest or speculate in the shares of companies incorporated in their own countries should enjoy better protection than those who invest or speculate in the shares of foreign companies, or in other stock-exchange securities. But the two other points of view are of much greater importance; all trading with unlimited liability offers certain safeguards to the creditors and to the general public, which are withdrawn in the case of trading with limited liability, and ought in that case to be replaced by corresponding safeguards of another kind. I mention the general public as distinguished from the creditors, because the dangers to which the general public is exposed by limited-liability trading are of a kind differing entirely from the risks incurred by creditors. Bad company law, as will be explained in the further course of this article, is a direct inducement to the parties concerned to trade in an unsound manner, and the effects of unsound trade, like those of bad sanitation, go very far beyond the area from which it proceeds. There is one principle which should never be disregarded, whenever the privilege of limited liability is conferred by law; the liability of a fund having a fixed and ascertainable value should be substituted for the unlimited liability of individuals. The value of this fund should on the formation of the company correspond with the amount of its nominal capital, and precautions should be taken to prevent, as much as possible, the diminution of this fund during the subsequent stages of the company's existence. Company law should, therefore, find means to assure (*a*) that the value of the property which represents the capital of a company on its formation shall correspond with the amount of the nominal paid-up capital of the company; (*b*) that property of the same value should continue to represent the paid-up capital of the company as long as it is not increased, and that on any increase of the paid-up capital the property representing the increase should be of a value at least equal to the nominal amount of the increase. I shall deal with each set of rules separately.

A. — Provisions as to Valuation of Assets on Formation of Company

The amount of the nominal capital with which a company is started in England is purely arbitrary, and need not stand in any relation to the value of the assets by which it is represented. A trader who converts his business into a company and keeps the shares himself has every inducement to fix the capital at a high figure, and as he is buyer and seller in one person, the price at which the business is sold — apart from the question of stamp duties — is absolutely immaterial.

If the shares are to be taken by the public the character which Company Promotion is apt to assume is shown by the following illustration. A trader wants to sell his business, which is worth £10,000, and approaches a financial agent conversant with such matters. The agent enters into a conditional contract whereby he agrees to buy the business in the event of his being able to form a company with a paid-up capital of £50,000. The price promised under the circumstances would probably be £10,000 in cash and the same amount in shares. The agent then tries to find some financiers willing to form a syndicate for the purpose; if these are found they are substituted as purchasers for the financial agent, who would probably be satisfied with £5000 for his profit on the transaction. These £5000 would probably be divided by him with some friends who helped to collect the members of the syndicate. The syndicate would subsequently sell the business to the newly formed company for the £50,000, and if they succeed in placing the whole of the shares they will, under the above-mentioned circumstances, obtain a gross profit of £25,000, but out of this sum some other intermediaries must be paid, legal expenses and stamp duties must be disbursed, and, to judge from recent revelations, the financial press must receive encouragement. The final result of all this is that the company acquires the property at a price representing five times its real value, the difference being divided by a number of people who have all in their way helped to float the company. It is well

known that this rate of profit is by no means exceptional and is frequently exceeded.

Another circumstance has also to be taken into consideration in places in which British Company Law is applied.

Assuming in the case just mentioned, that the public do not take all the shares, the syndicate may consider it worth while to go to allotment on the amount subscribed, and to trust to chance as to placing the rest of the shares at a subsequent period. In the instance given above this would have no effect on the working of the company, as the company would not get any of the proceeds of the shares in any event, but in some cases the purchase price does not absorb the whole of the nominal capital, some portion of the latter being reserved as a working capital; in such a case the company has of course to suffer by the non-success of the issue.

Thus it will be seen that the principle of establishing a definite fund available for the payment of the company's debts, the value of which can easily be ascertained, is in this country departed from in two ways: (1) by the absence of provisions insuring that the property in which the capital is invested in the first instance is taken over at a price representing its true value; (2) by the absence of provisions preventing a company from starting business before the whole of its capital has been subscribed. As regards the second point, the bill which is now before Parliament provides a partial remedy by requiring a statement as to the minimum amount of subscriptions on which the company will proceed to allotment, but this mode of dealing with the matter, though affording a certain amount of protection to subscribers for shares, does not in any way benefit the interests of the creditors or of the general public.

In Germany the genuine nature of the valuation put on the original assets is secured by elaborate provisions which I shall deal with at length, and the starting of business with an insufficiently subscribed capital is prevented by the rules laid down in sections 195 and 200 of the new mercantile code, according to which the corporate existence of a company cannot possibly begin before its whole capital has been subscribed for, and before at least 25 per cent of the amount payable in cash is in the

actual possession of the managers. There are two modes of formation permissible in Germany: (1) the *simultaneous* method, according to which the promoters take up the whole capital and offer it to the public after the formation of the company; (2) the *successive* method, which enables the promoters to offer the shares before the registration of the company; but in either case the subscription of the whole capital must be complete before the company can begin business.

These requirements as to the subscription of the capital would not be of much importance, if the first point to which I have called attention, namely, the adequacy of the value of the property in which the capital is invested, had not been properly attended to. This was done by provisions requiring the following things: (*a*) that certain matters relating to the history of the formation of the company should be inserted into the articles of the company; (*b*) that the promoters should make a report on the promotion transactions, for the accuracy and completeness of which they are civilly and criminally liable; (*c*) by provisions requiring the members of both boards of the company to examine into the circumstances of the formation of the company; (*d*) by provisions requiring an examination by independent auditors in certain cases.

(*a*) The articles have to state (among other things):

(1) The nature of any consideration not being cash against which any shares are issued.

(2) The names of any persons from whom the company on its formation is to acquire any property, and the prices at which any such property is to be acquired.

(3) The total amount of any payments to be made by the company for services rendered in connection with the promotion of the company.

(*b*) In all cases in which any shares are issued for any consideration not being cash, or in which any property is to be acquired on the formation of the company, the promoters have to prepare and sign a written report, in which they have to set out the circumstances from which it appears that the property to be taken over in lieu of cash or to be acquired by the company is worth the amount for which it is to be taken. In this report

all transactions which led up to the ultimate sale of the property in question to the company must be mentioned, together with all prices paid within the preceding two years for the purchase or construction of any part of such property; in the case of a company taking over a whole undertaking the results of the trading of the two preceding years must also be set forth. The term "promoter," according to c. 187, includes all signatories of the articles of association, and also all persons whose shares are not paid up in cash, and section 202 provides that all such promoters are answerable to the company in damages in respect of any inaccuracy or incompleteness in the above-mentioned report; and also that they have to refund to the company any pecuniary benefit conferred by them to any person in connection with the purchase of the property of which no mention is made in the report. Promoters are released from these liabilities if they can prove that the inaccuracy or incompleteness of the report was neither known to them nor could have been known to them if they had applied the diligence of a prudent trader. Third parties who have received any benefit not disclosed in the report are also liable in damages, if the concealment was (or under the circumstances of the case ought to have been) known to them. Any promoter who knowingly makes any false statement in the report in question is also punishable with imprisonment and a maximum fine of 20,000 marks (section 313).

(*c*) Every German company has a supervising board and a managing board; in the case of a "simultaneous" formation the first boards are appointed when the articles of association are signed; in the rare case of a "successive" formation, the general meeting, which has to be held before the registration of the company, has to appoint them. Both these boards have to examine and report on all the circumstances of the formation of the company. They have in particular to inquire into the accuracy and completeness of the statements contained in the promoters' report, and this inquiry must also include the examination of the question, whether the prices at which any property to be taken over by the company are open to any objection (sections 192, 193).

(*d*) In any case in which one of the members of either board is

a promoter or derives any pecuniary benefit from the promotion of the company, and also in any case in which any property is to be taken over by the company on its formation, independent auditors appointed by the local chamber of commerce have to examine and report as well as the two boards and in the same manner. The auditors' report under the law of 1884 had degenerated into a mere formality, but the new code has added some provisions which will make it much more effective in the future.

Under the new law the auditors may ask for any information in connection with the subject of their inquiry which appears relevant to them, and in case of any dispute with the promoters as to the necessity of any such information, the authority by whom the auditors were appointed is entitled to give a binding decision. As long as the promoters decline to give the information, the auditors' report is not issued and the incorporation of the company cannot take place. The remuneration payable to the auditors is not fixed by any person connected with the company, but by the authority by whom they are appointed (section 194). Any agreement to the contrary is void. (Esser, page 24.)

All the reports have to be filed in the registry and are open to public inspection (sections 195, 199). This right of inspection is not taken advantage of to a large extent, but if the reports contained any damaging facts their contents would soon be known to the public and prevent them from taking shares. As mentioned before, the simultaneous method of formation is almost universally applied, and under that method the promoters have to keep the shares and pay up in full, unless the public comes forward. This circumstance alone is a sufficient check against purchases of property at excessive prices.

It is no doubt true that most persons who take shares in new companies are not very watchful in reading reports or inspecting documents, but if there is only one watchful person any irregularity will soon be known in the circles in which shares are usually placed and will damp the enthusiasm, which might otherwise have been created in favor of the new issue.

It may of course still happen that the prices at which property is taken over on the formation of a new company are too high, but the unnatural increase of these prices caused by the com-

missions and profits of middlemen, which is such a characteristic feature of English company promoting, is a practical impossibility under the above-mentioned provisions.

The question naturally arises, How do people in Germany, who take trouble or risk in the formation of a new company, obtain the remuneration, without which they would hardly be inclined to enter into such transactions? The answer is that the profit is entirely derived from the premium at which the shares are sold to the public. It is clear that the profits obtained in this manner cannot be nearly as high as those which are frequently obtained by the English methods of company promotion, but large and adequate profits are frequently obtained, which nobody can object to, as they are perfectly open. The necessity of paying for the shares before they are issued to the public shuts out a certain class of professional company promoters, who may now be said to be non-existent in Germany, but the starving out of this class of men is an advantage from the moral as well as from the economic point of view.

The principal point is this: in England the promoters' and middlemen's profit is added to the nominal capital of a company, whilst in Germany it is added to the price of the shares. To the shareholder it may be a matter of indifference whether he buys shares from the promoters at 100 per cent premium, or whether the company buys its assets at twice their real value and sells him his shares at par, but a creditor is necessarily misled by being told that a company's paid-up capital is £100,000, when the real value of its property is £50,000, the rest consisting of promoters' profits. Moreover, the necessity of paying dividends on a capital swollen by such profits leads to the adoption of unsound methods of trading and bookkeeping.

It has been suggested that the provisions requiring the whole of a company's capital to be taken up before the registration of the company may be evaded by the employment of dummies, in whose names the shares are taken, the real promoters remaining in the background and only pocketing the profit on the sale of the shares in case of such a profit being realized; but such a course does not appear to be adopted in practice, and would, if adopted, in all probability defeat its own object; if the promot-

ers' report was signed by persons willing and able to contemplate their liability with the indifference of the "*vacuus viator*," the public would not be tempted to take the shares, and the real promoters would lose their chance of a profit.

There are some other possible modes of evasion which have been specially guarded against by the German law.

It is enacted by section 207 that all contracts made within the first two years after the formation of the company for the purchase or construction of any buildings or plant intended to be used permanently for the purposes of the company's business, or of any land or other immovable property at a price exceeding one-tenth of the company's capital, are invalid unless confirmed at a general meeting in a special manner which enables shareholders holding only 26 per cent of the company's capital to defeat the scheme.

A report must be presented to the meeting by the supervising board, which, together with the contract, must, in case of adoption by the meeting, be filed in the mercantile registry. The members of the supervising board are, according to section 208, responsible for the contents of this report in the same way as they are responsible for the original report on the formation of the company.

In the case of an increase of capital, sections 278 and 279 provide for similar safeguards as those existing with regard to the original formation of a company.

B. — Provisions presenting a Diminution of the Property representing a Company's Capital

The measures which are taken for the purpose of assuring that the amount of the original capital of a company is truly represented by the value of its property are insufficient, unless they are accompanied by measures preventing, as far as possible, the diminution of the capital during the subsequent stages of the company's existence. In this respect also the provisions of English law are hopelessly inadequate. The courts have indeed frequently laid down the rule that dividends must not be paid out of capital, but the payment of dividends, notwithstanding

the contemporaneous diminution or depreciation of that part of its property which is called "fixed capital" is considered legitimate and cannot be prevented.

A trust company holding stock, which during the last business year has paid 50 per cent dividend, but before the end of the year became utterly worthless, may include the 50 per cent in its yearly profit, without deducting a penny for the depreciation of the property from which this profit was derived. This is not called paying dividends out of capital.[1] A company, owning a mining lease, may include the proceeds of the minerals extracted in each year in the profit of that year and value the mine at cost price in its balance sheet, although in the course of a few years the mine will be worthless and the lease will have expired. This is not paying dividends out of capital.[2] A company having paid £100,000 for good will and earning an income of £1000 with every prospect of earning nothing, or less than nothing, in the following year, may divide the profit as dividend, whilst the good will is still valued at £100,000. This is not paying dividends out of capital.

The distinction between the depreciation of fixed and circulating capital, which is the basis of these decisions, is unsound from a mercantile point of view.

Income derived from any source, which by furnishing the income becomes gradually exhausted, cannot be wholly considered as income. It is partly income and partly re-payment of capital, like a terminable annuity. There is hardly any property, classed as fixed capital, which is not of a wasting nature. In some cases the wasting process is very slow, in some cases it is very fast, but the rate of waste can be generally calculated with sufficient accuracy to enable a trader to write off the proper amount for depreciation.

If it was really correct to disregard the depreciation of the fixed part of the capital in the calculation of the profits, the total disappearance of such property would not have to be considered either; new buildings and machines would have to be provided and their cost added to the "Buildings and Machinery

[1] *Verner* v. *General, &c., Investment Trust* (1894), 2 Ch. 239.
[2] *Lee* v. *Neuchatel Asphalte Company*, 41 Ch. D. 1.

Account," but the demolished buildings and the disused machinery could still be valued at cost price. In the case of a private partnership such a mode of trading would invariably lead those who adopt it into the bankruptcy court, if it were persisted in for any length of time, but in the case of a private partnership, the fact that retiring partners must from time to time be paid out on the basis of the balance sheet of the last year, acts as an effective check against the overvaluation of permanent investments.

In the case of companies omitting to provide for the waste, new capital must of course be required from time to time, and such new capital may up to a certain point be furnished by a confiding public on the strength of the forced dividends, but the crash will inevitably come some day.

Another objection against the distinction between the two kinds of capital is pointed out by Mr. Palmer (one of the most experienced company lawyers in this country): "It is extremely difficult to determine what is and what is not fixed capital. Thus shares or other assets are sometimes bought by a company without any distinct determination whether they shall be kept or resold . . . further intentions change. Supposing a company formed to buy, sell, hold by way of investment, and deal in shares and that it holds some shares intending at the time to sell, they are circulating capital, but if they happen to fall in price, the company may determine to keep them and thereupon they become fixed capital, and a few months afterwards the company may determine to sell them and thereupon they again become circulating capital." (Company Precedents, Part I, 7th ed., page 540.)

The distinction which the courts have made between circulating and fixed capital and the rule which they have laid down, according to which a company may continue paying dividends notwithstanding the gradual disappearance of its "fixed" capital, have had the further consequence, that the notion of a permanent fund on which the creditors of a limited company can rely, has been entirely abandoned. This was shown in a very recent case,[1] in which it was held that a loss shown on the working of a particular year, for which no reserve is available,

[1] *In re National Bank of Wales* (1899), 2 Ch. 629, 669.

need not be replaced from the profit of the following year. The result of this, translated into bookkeeping language, is, that a debit balance on the profit and loss account may be carried forward as an asset in the balance sheet, and that, whilst this is done, dividends may be divided among the shareholders. By judicious bookkeeping a company may easily arrange to have a profit in each alternate year and a loss in each following year. The loss diminishes the capital, and the profit goes to the shareholders until the capital is exhausted. A law which allows such a state of things turns limited liability into a source of serious public danger. From the point of view of common business prudence the following rules ought to be strictly maintained: a sum representing the depreciation of a company's property, whether acquired for permanent investment or for the purpose of resale, should be deducted from the profits in each year, and either credited to a depreciation account or deducted from the amount at which such property was previously valued. If on the working of a year a loss is shown which cannot be met out of any reserve fund, that loss must be carried forward on profit and loss account, but no dividends can be paid until such debit balance has disappeared from the books.

Some difficulty arises as to the question, What constitutes depreciation? Is it the natural wear and tear and the gradual disappearance of the object only, or is it also the diminution in market or selling value produced by other causes? In this respect the distinction between fixed and circulating capital offers some guidance.

As regards property, such as buildings and machinery, bought or constructed for the purpose of being retained and used for the permanent purposes of the company, the selling value is not really of importance; the durability or usefulness of any such property is not affected by the conditions which affect the price, at which it can be sold, and the company is not any poorer because it is unable to sell such property at cost price; as regards property bought or manufactured for the purpose of being sold or resold, it is of course necessary to consider the market price, which is the only tests of its value The two classes of property just mentioned do not as a rule exhaust the whole of a company's

property; book debts, which do not belong to either class, are frequently an important item. It is generally recognized in this country that a reduction ought to be made with reference to bad and doubtful debts, but great laxity prevails with reference to debts payable in a foreign paper currency or in a currency based on silver; it is customary for bookkeeping purposes to convert these debts into sterling currency at a fixed rate of exchange, and this fixed rate is sometimes called the "par value" — as if there could be a par value between a metallic currency and a paper currency, or between a gold currency and a silver currency. There is, then, in such cases a tendency to disregard all fluctuations and to retain the old rate of conversion, although it differs materially from the actual rate. In cases where such debts are only of occasional occurrence this is not so important, but in the case of companies whose principal outstandings remain permanently in foreign countries, the consequences may be very serious; an English company having outstandings of a permanent nature in Brazil and converting them into sterling money at the old rate of 24*d.*, whilst the present rate is about 8*d.*, is doing exactly the same thing as if they valued their outstanding debts at their full value, notwithstanding the fact that two-thirds of the same were known to be absolutely irrecoverable; yet English law seems to allow this system of bookkeeping, and the payment of dividends cannot be prevented, although the company's capital is dwindling away by the depreciation of the currency in which it is invested.

As regards stock-exchange securities bought for permanent investment, it may be somewhat inconsistent to prescribe deductions in respect of loss of market value, but such deductions are prudent, especially in cases where the fall in the market price is due to causes materially affecting their intrinsic value. When, *e.g.*, a stock-exchange security has ceased to pay dividends, it ceases to serve the purpose of investment.

The German law proceeds on the principles for which I have contended in the foregoing observations. Section 261 enacts that (subject to the modifications to which I shall have to refer) the provisions contained in the mercantile code as to the balance sheets of traders generally are to be observed; according to these

provisions all assets and liabilities must be taken at the value, which they had on the date, as from which the balance sheet is made out; debts must be taken at their probable value and irrecoverable debts be written off entirely. The modifications in the case of the balance sheets of companies are the following:

(1) Stock-exchange securities and goods having a stock-exchange or market value must be taken at such stock-exchange or market price, if such stock-exchange or market price is below the cost price; in any other case they are to be taken at cost price.

(2) Other assets are to be taken at a price not exceeding the cost price.

(3) Buildings and plant and other property not intended to be sold or resold, and being used for the permanent purposes of the company's business, may, notwithstanding the fact that their actual value is smaller, be taken at cost price, provided a sufficient amount is written off or placed to a depreciation account, by which the loss by waste or wear and tear is provided for.

(4) Promotion or administration expenses may not be included among the assets.

(5) The amount of the capital and of all reserve and depreciation funds must be included among the liabilities.

(6) The profit or loss resulting from a comparison of the assets with the liabilities must be stated separately at the end of the balance sheet.

It will be noticed from these rules that no asset may be valued above cost price, even in a case where the actual value is above cost price; this provision does not appear very logical at first sight, and it may be urged that it is just as wrong to undervalue the assets as to overvalue them; as regards the latter observation it is obvious that the only persons damaged by an undervaluation are particular classes of shareholders or directors or managers, whose remunerations vary with the profits, whilst an overvaluation, as I have shown above, causes an injury, not only to the solidity of the company and to the interests of its creditors, but also to its competitors and the public generally, through the encouragement which it gives to unsound trading.

There is therefore much more inducement to provide against overvaluation and to disregard the risk of undervaluation which, considering the many temptations in favor of high dividends, operating on the directors and managers of a company, is really not very serious. The illogical nature of the provisions in question cannot be entirely denied, but it was thought prudent that a company should not pay dividends out of unrealized profits, having also regard to the fact that the stock-exchange price or market price is not always quite genuine, and may easily be sent up by fictitious transactions for the very purpose of enabling a company to value securities or goods at a price producing a profit available for the company's dividends.

One of the consequences of the rule, that no asset can be taken above cost price, is that assets which were acquired gratuitously cannot be valued at anything. Some writers have asked, why a company who had received any property by way of gift should not be able to include their value among its assets; but it is hardly worth while to consider this point, as generous benefactors, who give away their savings to trading companies, are freaks of nature which need not trouble the legislator's mind.

A company which acquires the good will of a business for valuable consideration, may value such good will for its balance sheet at cost price, subject to the proper deduction for depreciation, but it cannot value its own good will if nothing was paid for it. (See Ring, pages 46, 602, 613.)

The German code does not lay down any rule as to the manner in which depreciation by wear and tear and waste ought to be calculated. In some cases the natural depreciation is obvious, as in the cases of leases or patents expiring after a certain number of years. The rate of depreciation in the case of buildings, machinery, etc., can also be easily ascertained with the advice of experts; in other cases, common sense and prudence will usually find a way out of the difficulty. As regards good will, depending on personal efforts and qualities, a somewhat rapid rate of depreciation ought to be allowed for; where good will is attached to particular premises, as in the case of inns and hotels, its value is not generally taken as a separate item, but included

in the value of the premises. For these reasons the item of good will is not frequently seen in the balance sheets of German companies.

Another rule of law, which tends to the preservation of the capital of German companies, is contained in section 262, which provides that a reserve is to be formed in the following way: (1) at least one-twentieth part of the net profit of each year is to be credited to this fund, until it shall have reached the tenth part of the company's capital, or such larger part of such capital, as shall be provided in the articles; (2) in addition to this, any net premium realized by the issue of any part of the company's capital must be placed to the reserve fund, as well as (3) any amounts paid by shareholders in consideration of any preferential rights accorded to their shares (unless such payments are used for the purpose of making good any special losses).

The statutory reserve fund cannot be used for the payment of dividends in bad years, but separate reserve funds may be formed for that purpose. (Esser, page 164; Ring, page 631.)

The provisions which I have hitherto discussed are intended to prevent the following mischiefs:

(1) The watering of the original capital.

(2) The dwindling away of the company's assets by the omission of any allowance for their depreciation in the balance sheets.

They cannot, of course, prevent the gradual disappearance of the company's capital by losses in business in cases in which profits cease altogether, but there are provisions which prevent a company from carrying on business after a considerable part of its assets have been lost.

It is provided by section 240:

(1) That if, on the drawing up of any yearly or intermediate balance sheet, it appears that one-half of the company's capital has been lost, the managing board must immediately convene a general meeting, to whom the state of facts has to be submitted.

(2) That in the case of the insolvency of the company, and also in the case of any yearly or intermediate balance sheet, disclosing the fact, that the liabilities of the company exceed its

assets, it is the duty of the managing board to initiate bankruptcy proceedings without delay. A disregard of this provision is punishable with three months' imprisonment and a fine (section 315–2).

There are no similar rules in English law; in the case of insolvency, winding-up proceedings are of course taken as a general rule, but the mere fact that the assets are insufficient to pay its debts, does not prevent a company from continuing business. As long as a company can pay its way by the use of credit or otherwise, so long it can continue to trade in this country; in some lucky cases, this may enable it to retrieve its losses and to start a more prosperous career, but in the larger number of instances, a company, having reached such a low condition, has to procure accommodation on terms so onerous that the chances of profitable trading are very much reduced. The German rule is therefore preferable in the interest of creditors and of the general public.

The German law on stock-exchange transactions passed in 1896 has no such wide purposes as the above-quoted sections of the mercantile code relating to companies; its only object was to hinder certain kinds of stock-exchange speculations; in so far as it deals with shares in companies, it refers not merely to shares in German companies, but to shares generally, nor does it refer to all dealings in such shares, but only to dealings on any authorized stock exchange. In England the stock exchanges can at their discretion make rules as to the conditions, under which a settlement or quotation is granted to any shares or debentures or other securities, and this was also the case in Germany prior to 1896, but since the statute of that date, the stock-exchange rules are partly fixed by law. The provisions in question have therefore no direct connection with company law, but as they have to be considered on the formation of a company, whose shares are to be dealt in on the stock exchanges, and also on any increase of its capital, some reference must be made to them.

The rules in question prescribe:

(1) The compulsory issue of a prospectus, the authors of which are under a specially stringent liability;

(2) The lapse of a space of time between the incorporation of the company and the public issue of its shares;

(3) The fixing of a minimum capital for companies whose shares are to be dealt in on any stock exchange.

As regards the issue of a prospectus, it is provided by section 38 of the statute, that before any security is admitted for the purpose of being dealt in and quoted on any stock exchange, a prospectus must be issued, containing all information, which is of any importance for the purpose of ascertaining its true value. German government securities are exempted, and other securities may be exempted by the government of the state in which the application is made, but all shares in companies, whether incorporated in Germany or elsewhere, are included in any case.

It was already provided by the mercantile code, that persons issuing a prospectus by which shares are offered within two years from the incorporation of a company, are liable in damages in respect of inaccuracies or omissions in such prospectus. This liability can be enforced by the company only, whilst the liability imposed by the stock-exchange statute in respect to misstatements in the prospectus can be enforced by any holder of the security to which the prospectus refers. According to section 43 of that statute all persons who have issued or directed the issue of any prospectus containing any inaccurate statement on any matter affecting the value of the security are jointly and separately liable for any loss caused thereby, in so far as they knew, or ought in the absence of gross carelessness to have known, that the statement was incorrect. In the same way they are liable in respect of omissions as to essential facts, if caused by them knowingly or recklessly. If the inaccuracy or incompleteness was known to the claimant at the time of the purchase, or ought to have been known to him, on the application of the care usually given to his own affairs, he loses his claim to damages or restitution.

As regards the interval of time which must elapse before a company's shares can be dealt in on a German stock exchange, it is provided by section 39 that the shares of any undertaking which has been converted into a company cannot be admitted

among the securities negotiable on any German stock exchange, unless at least a year has elapsed from the date of the registration of the company, and unless the first yearly balance sheet of the company has been published together with the profit and loss account. Power is given to the state government of the place in which the shares are to be dealt in, to dispense from this rule in exceptional cases. It will be noticed that this close time is only prescribed in the case of companies taking over an existing business; the shares of a company starting a new business may be publicly dealt in at once. The wisdom of the rule is very doubtful. A company cannot be registered before its capital is fully subscribed. The promoters must therefore hold the whole of the shares for at least a year and probably some months longer, as in most cases some time will elapse after the end of the year before the balance sheet can be drawn up and published; some compensation must, of course, be sought for the prolongation of the risk and capital outlay, and this compensation has, of course, to be paid by the public. On the other hand the safeguard is purely imaginary. By judicious manipulation profits belonging to a former year or to the subsequent year may be squeezed into the critical twelve months, so as to produce a specially good profit and loss account, and the idea that the public in this way have an opportunity to see the working of the undertaking before they are asked to subscribe to it is therefore purely imaginary.

The third regulation introduced by the stock-exchange statute is intended to prevent stock-exchange transactions in the shares of companies having a small capital only. The fixing of the minimum capital for each stock exchange is left to the federal council by section 42, which section also gives power to the same body to make further regulation for the admission of securities to any stock exchange.

An order was issued by the federal council pursuant to this power, containing the following provisions:

(1) The minimum capital of companies whose shares are to be dealt in at Berlin, Hamburg or Frankfort must be £50,000, whilst for all other stock exchanges a minimum capital of £25,000 is fixed.

(2) The prospectus must state (*a*) the name of the company, (*b*) the clause in the articles or resolution authorizing the issue, (*c*) the purposes for which the proceeds of the issue are to be applied, (*d*) the amount of the total issue, the amount offered, and the amount retained, and the time during which the last-named amount is to be retained by the promoters.

The provisions about statements in prospectuses and dealings on the stock exchanges are of minor importance and affect a limited class only; those relating to the prevention of over-capitalization and the preservation of capital affect the whole trade of the country. It is stated on good authority that some branches of trade (such as the cycle industry) are rapidly going down in England owing to the fact that they are worked by overcapitalized companies. This will show that the reform of company law has other objects than the protection of careless persons against unsound investments. If this fact could be understood and realized by public opinion, it would be seen that measures like those proposed in the bill which is now before Parliament touch the real mischief as little as the previous voluminous legislation on the subject.

ERNEST SCHUSTER.

XVII

THE NEW COMPANIES ACT, 1900[1]

THE wickedness of the company promoter is no new thing: in the wild bubble craze of 1715 one gentleman proposed to float a bubble, or company, to import jackasses from Spain, and another a company for a purpose "to be disclosed hereafter," and decamped in the evening with his pocket full of guineas; but at the same time it is the adoption of the principle of limited liability which has given the company promoter his great opportunity. That principle is now so familiar that it is difficult to realize how modern it is — in fact, not yet fifty years old. Since 1862, when previous tentative experiments of Parliament were reconsidered and embodied in the Code Napoleon of the limited company, there have been numerous amending Acts, but it is only within the last six or seven years that public opinion, of the city prince no less than of the country parson, has demanded radical reform.

The late Lord Chief Justice brought before the public in 1898 some startling figures.[2] During the seven years from 1891 to 1897, 28 millions of money was lost, 20 odd to shareholders, and 7 to creditors. These figures, though much quoted, require very considerable correction, for they are at the same time too comprehensive, and not comprehensive enough; on the one hand Lord Russell took no account of the losses made by companies wound up voluntarily and not under the jurisdiction of the Court, and if these be added, the average *annual* loss for the five years ending December, 1897, works out at 12 millions of money at

[1] From the *Economic Journal*, Vol. XI, 1901, pp. 180–192. The substance of this paper was delivered as a lecture at the London Chamber of Commerce, the President, W. Sandeman, Esq., in the Chair, on Wednesday, Nov. 21, 1900.

[2] See *Times*, Nov. 10, 1898.

the least.[1] On the other hand, the whole basis on which these figures of assumed loss are calculated is unsound; for much of the apparent loss of capital on winding up is compensated by schemes of subsequent reconstruction or amalgamation.[2]

The law allows, no doubt, far greater freedom in England than is possible abroad; anything, for instance, like the "simultaneous formation" usually employed in Germany, where the promoters *must* themselves take all the shares, would not be tolerated here for a moment; and many have felt there is a grave danger in sacrificing any portion of this freedom.

"Restrictive provisions which may have the effect of either curtailing the facilities for the formation of companies which bring so much business to England, or of embarrassing the administration of companies, or deterring the best class of men from becoming Directors, are not to be lightly entertained."[3]

In 1894 a Department Committee presided over by Lord Davey was appointed and reported in 1895:[4] the Committee received memoranda from many Chambers of Commerce and other public bodies throughout the United Kingdom, and took evidence as to the law of companies in France, Germany and America, and may be said to have brought within the four corners of a blue book every suggestion that the wit of man has ever heard, thought or dreamt of in connection with Company Law Reform. The Committee at the end of their report submitted a draft bill of 49 clauses: this Bill was examined by a committee of the House of Lords in 1897, and two following years, and was finally introduced into Parliament by the Secre-

[1] Eighth General Annual Report by the Board of Trade in companies winding up in 1899, p. 6; see also return of Joint Stock Companies, August, 1899, pp. 326–329.

[2] This the Board of Trade officials are the first to admit; see Eighth General Annual Report, *sup. cit.*, p. 6. How much apparent loss is so made good the Board of Trade Report says it is impossible to estimate.

[3] Report of Lord Davey's Committee, 1895, p. vi. Evidence was produced before that committee that the paid-up capital of companies in England amounted in 1894 to 1035 millions sterling, of companies in France to 420 millions, and of German companies to 300 millions, giving a surplus to English companies over the other two countries of 315 millions.

[4] The committee consisted of thirteen names, all of the highest authority in the world of commerce and law, amongst them, Lord Justice Vaughan Williams, Mr. Justice Buckley, Mr. Palmer, Mr. John Hollams and Sir Albert Rollit.

tary to the Board of Trade last summer and passed into law: every clause in the Bill has been tossed to and fro a hundred times; outworks against roguery skilfully run up by Mr. Palmer one day were swept away by the flood of Mr. Justice Buckley's caustic criticisms the next: every line of the Bill has been swamped in a flood of discussion and printers' ink: it is sad that after such a lengthy period of incubation the legislative chicken has emerged so imperfectly shaped.

The result of all this discussion has of course been a compromise, and the original 49 sections have now shrunk to 36. The discussions on the Bill revealed general agreement as to the more serious mischief to be remedied, and it is worth while to enumerate the prominent ones.

1. *The One Man Company.* — In order to secure registration with limited liability the Act of 1862 requires the signatures of seven[1] persons to the original memorandum of incorporation, each taking one share in the company, but up to the present English law has taken no heed whether those seven signatories are dummies or no; that company may be really constituted by one man who pays the first subscription for each of the other six, and so secures their signatures.[2]

2. *Insufficient Subscription.* — Many companies proceed to

[1] In Germany, since 1892, limited liability partnerships — Gesellschaften mit beschrankter Haftung — may exist. American law, of course, varies: in the state of New Jersey "three or more persons may become a corporation" (*i.e.* a company), Revision of 1896, Sec. 6: three also are sufficient for incorporation in the state of New York, Law of 1890, Sec. 2: Lord Justice Lindley advocated that one person should be allowed the privileges of incorporation provided he wrote *Limited* after his name.

[2] This is the result of the decision of the House of Lords in Aron Solomon's case in 1896. Solomon floated off his business as a leather merchant into a company consisting of himself, and his wife and daughter and four sons, from whom he received in payment £20,000 in shares, and £10,000 in debentures, with a floating charge over the whole business; he was managing director and could outvote the other six signatories, and by means of his debentures come in with priority in a winding up over ordinary creditors; when the inevitable winding up came the liquidator tried to get the whole set aside as futile in law and fraudulent in fact, that it was no company, but one man attempting to evade the ordinary law of bankruptcy and trade with limited liability by means of six dummies. Mr. Justice Vaughan Williams and the Court of Appeal sympathized with the liquidator, but the House of Lords held that the Act was satisfied with actual signatories whatever their motives.

allotment, though totally insufficient capital has been subscribed. English law, from 1862 up till January 1, 1901, has required neither a minimum amount per each share nor a minimum amount of shares to be subscribed before the company can proceed with its business.[1]

The Registrar of joint stock companies quotes a curious case which illustrates the absolute absence of restraint in these respects prior to the present Act; in 1891 "The Ancient Gold Fields of Africa, Limited" was registered with a capital of £10,000, divided into 9,600,000 shares of one farthing each; the total subscribed capital according to the last return was $1\frac{3}{4}$*d.*, *i.e.* precisely one share for each of the original seven signatories. It is obvious that a company which starts on its career with too little working capital is as much foredoomed to failure as a school without scholars.

3. *Overloading the Purchase-price.*—The law regards directors and promoters as trustees for the shareholders of the property of the company, but the difficulties of securing disclosures have always made evasions easy, and of these overloading the purchase-price was one of the commonest: in the normal course a promoter finds a flourishing industrial concern worth, say, £10,000, and decides to float it as a company for as much more as he can get; he obtains from the proprietors a contract or option to sell for £10,000; he then forms a small syndicate which is registered as a company, and purports to sell to it the contract or option at an enhanced price, say, £50,000; the syndicate next sells to the person who is to appear before the public as the vendor of the business, again, of course, with an advance;

[1] Abroad limits are usually fixed in both cases. As to the amount of the share this was in France originally required to be at least 100 francs, but in 1893 this limit was reduced to 25 francs, so as to encourage the small investors; in Germany the lowest amount per share is usually £50, though £10 shares are allowed in exceptional cases (1895 Report, p. 15). In America, New York requires shares to be not less than five, or more than one hundred dollars (law of 1890, Sec. 2, 4). As to amount of capital subscribed, in France, by the law of 1893, the whole capital must be subscribed and one-quarter paid up, and the same rule holds good in Germany. New York requires at least five hundred dollars with which to begin business (Sec. 4), and one-half of the whole capital stock to be paid up within a year (Sec. 5). New Jersey requires a minimum of one thousand dollars with which to commence business (Sec. 8, iv).

probably by this time we have got to £100,000; and lastly, the nominal vendor purports to make what is called a provisional contract with another dummy called the trustee for the company, subject to adoption by the company; by this time we are in the region of high finance, and the price may be anything up to seven figures. The promoters thus keep piling up profits on each transaction, and the so-called contract with the syndicate, with the nominal vendor, and the provisional contract with the trustee for the company are obviously not real contracts, all these persons being the nominees of the promoters.

4. *The Prospectus.* — It was generally felt that much more might be legitimately required of the prospectus than was secured by the old law; that all the material facts connected with the promotion of the company should be stated, and the directors forced to sign, so as to pin them down to legal liability for all statements in the prospectus.

5. *Registration of Debentures.* —The whole machinery of debentures (*i.e.* generally mortgages issued by the company of all its property) is beset with difficulty; the common course nowadays is for the new-born company to issue both shares and debentures together, and for the vendor to take the debentures in payment and so keep his grip on the neck of the company. Take a case mentioned in the last Board of Trade Report in winding up, of the Savoy Press, Limited, where an undischarged bankrupt formed a company to purchase from himself a worthless publishing business which he had been carrying on for twelve months previously; the price was £1500 paid to him in cash, shares and debentures; the company ran for two and one-half years, incurred debts up to £600 to ordinary creditors, then the vendor came in, ousted the company, and resumed possession by his mortgage as debenture holder.

What makes a company debenture such a powerful instrument is that the law allows to the company what it does not to the private trader, viz., the power to mortgage the whole undertaking as a going concern, by what is known as a *floating charge* in the debenture. This does not affect the property of the company so long as the latter is solvent, and the company can freely deal with the property, sell, replace and even mortgage the

stock-in-trade, and so on; but directly the debenture holder proceeds to realize his security, the charge floats no longer, but attaches with limpet-like tenacity to all the property the company has at the moment. The Courts have so favored the floating charge that they even allow it now to attach to uncalled capital, though this result was not arrived at without a struggle,[1] and Lord Justice Romer[2] and others expressed strong opinions in favor of restricting floating charges so as not to attach to uncalled capital.

The Act of 1862 required each company to keep a register of mortgages, to be open to creditors and shareholders, but not to the general public. This provision, however, has long been a dead letter, for the Courts held that a mortgage was equally valid between the parties whether registered in the company register or not.

Lord Davey's Committee decided that in view of the peculiar advantages enjoyed by companies the law demanded amendment, and that a public register should be required, open to inspection by every one, to contain those particular kinds of mortgages or charges, with regard to which companies enjoyed a privileged position.

6. Lastly, there was much discussion about the rights and duties of auditors. Auditors are not valuers,[3] and must take much information at second hand, but the shareholders are entitled to believe they have some assurance that the company is sound if the balance sheet is signed by a competent firm of auditors. Proposals were made that balance sheets should be filed annually, and be open to public inspection, but this was resisted in the interests of both public and private companies.

[1] In principle this extension appears to be wrong, as it may be in effect to issue shares at a discount, so often declared to be contrary to the principle of the Act: if a company's capital is £100,000 in £1 shares, that, as Mr. Justice Buckley and others were never tired of insisting, should be a reality; supposing all the shares are subscribed for, but only 10*s*. is called up on each share, *i.e.* £50,000 in all. There is then £50,000 still uncalled, and any creditor should be able to rely on that as an asset of the company; yet if debentures with a floating charge are issued, as is usual, at the same time as the shares, the £50,000 uncalled is not really an asset at all; it is mortgaged to the debenture holders and the real capital of the company is only £50,000.

[2] 1897 Committee Report, p 19.

[3] See Lord Justice Lindley's evidence.

With the one man company, the new Act fails to deal directly, while indirectly the Act considerably strengthens its position. Doubts were suggested by a learned judge in a recent case,[1] whether the certificate of incorporation granted by the Registrar had really created the company, on the ground that some of the original seven signatures to the memorandum were not genuine. Section 1 of the new Act provides that the Registrar's certificate of incorporation shall be "conclusive evidence that all the requisitions of the Companies' Acts in respect of registration, and *of matters precedent and incidental thereto*, have been complied with," so that had Aron Solomon forged the other six signatures to his memorandum, his company would have been all the same duly constituted.[2] Nor does the new Act contain any clauses directly defining the powers and responsibilities of directors and promoters, the clauses in the draft bill on the point being erased,[3] on the ground that the existing law was probably sufficiently stringent to meet all cases of misconduct.[4] Further, some really useful clauses defining the nature of the balance sheet and what it should contain have also been dropped, and there is no doubt that the Act is the weaker for their omission.

The principle of the new Act may be described as "publicity rather than penalty"; to give the death-blow not so much to the fraudulent promoter, as to the ignorant shareholder, in this following the conception of the late Lord Chief Justice.[5]

[1] Mr. Justice Kekewich, in National Debenture Corporation, 1891, ch. 2, p. 37.

[2] A clause in the original draft bill providing that where the certificate of incorporation had been obtained by fraud, this should be a ground of winding up, was cut out in committee.

[3] The proposal was to require of all directors "*reasonable care and diligence*": Lord Justice Lindley was of opinion that these words only reënacted the existing law, Lord Justice Romer thought they went beyond it.

[4] The law, however, is undoubtedly defective in many points, *e.g* a promoter must make full disclosure to the company of any profits made, that is clear; but what is to happen if he does not? The company can of course have rescission of the contract: but if this be impracticable, the company cannot recover from the promoters their illicit profit; see the very recent case of *In re The Lady Forrest (Murchison) Goldmine*, *Law Journal*, Feb. 2, 1901, p. 54.

[5] "When appeals are made to the public to subscribe to the capital of undertakings, everything ought to be aboveboard, no concealment, no secret profits."

It is of course obvious that the machinery of the Companies' Acts has been adopted by many entirely private concerns, the managers of which never intend to appeal to the public, or to let any shares go out of the hands of the very small circle of holders, but who for family or business reasons find the principle of limited liability very convenient. Such companies never *mean* to appeal to the public, and most of the evils which the Act was intended to deal with, consequently, cannot in such cases arise, while to impose hampering conditions as to publication of amount of capital or of the holdings of shares and so on, would only be to handicap them in competition with trade rivals. Many witnesses[1] were anxious to draw a hard and fast line between ordinary public companies and private or family concerns. The difficulty of definition, if nothing else, deterred the Committee from attempting such a division, which does to some extent exist on the Continent. But while refusing to draw any clear distinction directly, the Act does, in a half-hearted sort of way, mark a difference between the two classes. Most of the new stringent provisions are to apply only to companies "*which issue an invitation to the public to subscribe.*" These, in fact, are the key-words of the Act, and their definition and application are alike beset with difficulties. Take the definition alone. Must the invitation be a written or printed document, for it seems difficult to "issue" a verbal invitation? And what constitutes an invitation to the public? Would an invitation to all one's friends or to all the members of one's club come within the words? These are questions with which the Courts may be expected soon to be occupied, and the difficulty of applying the phrase will appear directly. Of the provisions of the act, some apply to all companies, whether incorporated before or since January 1, 1901, and some only to those which are incorporated since that date. To take first the chief provisions applicable:

A. To all companies.

1. In order to check the evils of proceeding to allotment with insufficient capital subscribed, which have already been alluded to, the act imposes two new restrictions: on every application for a share, the applicant must pay a sum not less than five

[1] *E.g.* Lord Justice Vaughan Williams and Mr. Sinclair.

per cent of the nominal amount of the share (Sec. 4 (3)); and further, on the occasion of the first allotment by a company, the act requires for the first time a definite amount of money to be paid into the company's coffers before allotment, viz. either the whole amount of the shares offered to the public; or else, if the company has definitely fixed in its memorandum or articles, a certain amount less than the whole issue on which the directors may proceed to allotment, then that amount. If the amount subscribed does not comply with one or other of these conditions then the directors will be personally liable, after forty-eight days, to see that the money is repaid to the applicant, and any waiver by the applicant of the rules is expressly forbidden.[1]

Section 4 generally deals only with share capital, and with such capital when "offered to the public for subscription." As a further precaution, every company limited by shares is within one month of allotment to file a return with the Registrar of Joint Stock Companies, stating the amount of shares allotted, and the names and addresses of the allottees (Sec. 7): if any of the shares are allotted for services rendered, *e.g.* to a solicitor or vendor, and not for cash, the contract under which such shares are allotted, stating their amount and the services or consideration for which they have been given, must also be filed;[2] this contract will then be open to inspection by intending shareholders: this clause is in substitution for a similar and much discussed provision of the Act of 1867,[3] and is meant to secure the shareholders full knowledge as to the terms on which all shares have been allotted. Curiously enough this Section 7 as to allotment returns, applies to all share companies, public or private, and whether they have issued an invitation to the public to subscribe or not.

2. The third and fourth evils to be dealt with were overloading the purchase-price and the prospectus; and it is mainly through alterations in the law as to the latter that full disclosure is secured as to the former. The prospectus is defined as any "notice, circular, advertisement or other invitation, offering to the public for subscription or purchase any shares or debentures of a company," — not a very satisfactory definition: it would be

[1] Section 4, (3), (4), (5). [2] Section 7, 1, b. [3] Section 25.

comparatively easy to frame a document which would secure all the purpose of a prospectus, *i.e.* advertise the company and the fact that it was doing business and prepared to sell its shares without definitely "offering" them to "the public for subscription." But assuming a document within that definition, then Sections 9 and 10 apply a great variety of new rules to it: it is to be dated, signed by each director and filed with the Registrar (Sec. 9). The prospectus must further contain a great many features, which it is impossible to set out in anything like detail; it must state the contents of the memorandum, the number of founder's shares, and of qualification shares for directors, the minimum subscription on which the directors may proceed to allotment, together with particulars as to shares or debentures issued for considerations other than money. Then come several provisions to prevent overloading the purchase-price: the names and addresses of all vendors of property purchased by that company must appear, together with the amount payable in cash or shares to the vendor, and where there have been a *succession of vendors, then the amount paid to each;* the amount payable for good will (a frequent excuse for concealed fraud) is to be set out particularly: the sum paid as commission for procuring subscriptions, for preliminary expenses, and generally anything paid to the promoter, must also be clearly specified, and finally the dates and parties to every material contract entered into during the previous three years, not being a contract made in the ordinary course of business, must be set out, together with the place where such contracts may be inspected. In the bill as originally drawn disclosure was required of "every material contract and every material fact," but on the energetic protest of Mr. Palmer and others in committee these very wide words were somewhat narrowed and defined. With regard to second or subsequent prospectuses, if issued to the outside public (and not to members only), these provisions apply with modifications. Where published in a newspaper, too, the act takes pity on the pockets of the company and permits the requirements to be somewhat reduced, *e.g.* the contents of the memorandum may be omitted (Sec. 10, § 6). The act is silent as to the penalty if these rules are disobeyed: for any one, *e.g.* a

director, *wilfully* violating the act in this respect, the penalty is probably that of a misdemeanor, with two years' imprisonment under Section 28; and any purchaser of shares, injured by non-compliance, will have an action for damages against the person liable, though he probably will not be able to secure rescission of his contract with the company.[1] But it is specially provided that a director can escape liability by showing that he was not aware of the facts, which should have been disclosed and were not (Sec. 10, § 7). The act supplements, it does not abrogate, the liability of the company or directors under the old law. Owing to the definition of a prospectus the new rules can only apply to companies which appeal to the public.

3. The fifth difficulty mentioned above was the insufficient registration of debentures: and Section 14 provides that, without interfering with the old register (though that, as we saw, was practically disused), a new register is to be kept by the Registrar of Joint Stock Companies, open to public inspection (Sec. 14, § 8), and a copy of the new register is also to be kept at the companies' offices: in this register must be inserted (not all mortgages, note, nor even all debentures), but (a) *any mortgage or charge to secure debentures:* this refers to the usual covering deed to secure debentures, but would probably also include the registration of debentures containing charges in themselves and unaccompanied by any covering deed: (b) *a mortgage or charge on uncalled capital:* the act does not go so far as Lord Justice Romer proposed and abolish such mortgages altogether: (c) *a mortgage or charge created or evidenced by an instrument which if executed by an individual would be a bill of sale:* it is impossible here to venture into the quagmire of the Bills of Sale Acts, but the general result of this clause is that every mortgage or charge of "personal chattels" as defined by those acts must be registered, if the mortgage or charge is such as to give the mortgagee or chargee the power to take possession of the chattels: "personal chattels" under the Bills of Sale Acts do not include stocks and shares: this subsection will not therefore compel mortgages by deposit of shares with a bank to be registered: (d) *a floating charge on the whole undertaking or property of the company.*

[1] Cf., for similar difficulty, Companies' Act, 1837, Section 38, now repealed by Section 33 of the 1900 Act.

The old law, as we saw, rendered the old register useless by allowing validity to mortgages though not registered: the present act closes up this hole of escape by providing that in the above four cases the mortgage or charge unless registered within twenty-one days shall be void as against liquidators and creditors.

4. The last difficulty mentioned was the definition of the duties of the *auditor*. The provisions of the original bill on the subject have been much cut down, at the same time Sections 21, 22, 23 are useful, and a great improvement on the old law. Every company, whether public or private, whether appealing to the world for subscriptions or not, must have an auditor, properly remunerated: if an auditor is not appointed at the annual general meeting the Board of Trade may themselves appoint (Sec. 21): when appointed the auditors are to have full right of access to the company's books and the right to demand all necessary information; they are to sign the balance sheet and to add a certificate definitely stating whether their requirements as auditors have been complied with, and also whether in their view the balance sheet exhibits a true and correct view of the state of the company's affairs. It is curious to note that the act does not in terms say there is to be a balance sheet, only that the auditor is to sign it, presumably if there is one: it is very doubtful if the Courts will treat this as impliedly requiring a balance sheet in every case.

B. 1. With regard to regulations applicable only to companies incorporated since January 1, 1901, there are new rules laid down as to directors' qualification shares; the act does not insist on such a qualification, but says that, where the articles of the company require it, in order to avoid difficulties which arose, under the existing law, either the director must sign the memorandum for the amount of these shares or (if not an original director) sign and file with the Registrar a definite contract to take the proper number of shares from the company and pay for them (Sec. 2, ii); the section does not say explicitly with whom the contract is to be entered into, whether with the company or not. In any case these requirements are only necessary in the case of companies which "issue an invitation to the public to subscribe," a phrase which again causes difficulty. What is to

happen if a company, established on a private basis, and so managed for two years, then requires more capital and appeals to the public? Will the original appointment of directors become void because these rules were not observed? The act gives no answer to the question though the Courts will probably soon be called on to do so.

2. As already mentioned, the idea of a double registration (preliminary and final), of a company, common on the Continent, has not met with favor here, and Lord Davey's Committee reported against it. At the same time the act indirectly does adopt something of the sort by enacting in Section 6, that no company shall in future "commence business" until certain things have been done. This requirement will in no way affect the registration, but, unless and until the requirements of the section are complied with, the company though registered and in existence will be in suspense; it cannot make binding contracts nor borrow money. The preliminaries which must be complied with before business may be commenced are: (i) the proper amount of shares must have been allotted (*i.e.* either the whole amount offered or the proportion required by the articles, Sec. 4); (ii) the directors must have paid a required proportion of their qualification shares; and (iii) the secretary must have filed a statutory declaration that these rules have been complied with. The Registrar will then issue a certificate allowing the company to commence its business. This section again only applies to companies which "issue an invitation to the public to subscribe." A private company need not get the certificate to commence; but how are people, who wish to contract with a company, to know whether it is within the terms of this section or not? Whether it has appealed to the public or not? The point is important, for if it is a private company which has not gone to the public, then any person contracting with the company will be safe and the company will be bound, but otherwise, if the company has appealed to the public and not got the Registrar's certificate the company will not be bound by the contract.

3. Though these many restrictions are imposed on those companies which appeal to the public to subscribe, they are allowed one compensating privilege, viz. that in their case under-

writing is in future to be legal, and the long recognized custom of the City at length receives the sanction of the Legislature, but only on these express terms, viz. that the payment of the commission and the amount of rate per cent are authorized by the articles and disclosed by the prospectus[1] (Section 8).

Finally comes the question: Will the act achieve its purpose and check fraud? That it will provide work for the courts for years to come is clear. The drafting is not good and the difficulties of interpretation, some of which have been pointed out, are numerous. But criticisms of the act go deeper than that: the provisions as to the register of mortgages, the prospectus and the duties of auditors are all useful and should give some protection to the public, but as it is proverbially easy to drive a coach and four through Acts of Parliament, it should be easy to drive one through or at any rate round some of the chief provisions of this act: there is more than one way of circumventing the "commencement of business" provision, of which much is clearly expected; for instance, the company may in its articles mention some merely trifling sum on which to proceed to allotment, or if the promoters shirk the publicity of this course, they can simply start in a very small way, with seven members, all directors, a small capital of perhaps £100, issue this all nominally to the public, and so secure the Registrar's certificate; they could then at once launch out, increase their capital, say to £500,000 and proceed as at present.

Again, all the restrictions on companies which issue an invitation to the public can at one stroke be rendered futile: many companies domiciled near the Stock Exchange never appeal directly to the public at all; they are "baby creations," owing their birth to strong promoting parents, their shares are dealt in more or less artificially by the parent company, public quotations of the shares appear, and eventually the public rush in and buy: the effect of these clauses will probably be largely to encourage this underground process.

In a word, considering all the time spent upon it it is a pity that the act achieves so little.

MONTAGUE BARLOW.

[1] This clause has already received judicial interpretation. See *Burrows* v. *Matabele Gold Reef, Ltd.*, *Sol. Jo.*, 1901, p. 378.

XVIII

TRUST LITERATURE: A SURVEY AND CRITICISM[1]

THE industrial changes in the United States during the last two or three years have called forth inevitably a multitude of writings dealing with the problem of trusts,[2] just as, in the earlier years of the present decade, the condition of our national finances stimulated the discussion of the tariff or the silver question. It is the purpose of this article to present a brief survey of the recent output of trust literature, and then to attempt a critical estimate of the views advanced concerning the most important theoretical problems involved in the study of industrial consolidation.

I

In mere volume, at least, the product of the last few years is noteworthy. Discussion of the monopoly question in the United States seems to have begun early in the seventies, when popular dissatisfaction arose concerning railroad rates and management. Then, for a time, an occasional article in some periodical indicated only a fitful interest in the subject, until early in the eighties the formation of the Diamond Match Company and the Standard Oil Trust caused a livelier discussion of the problem of monopoly. Later in the same decade the appearance of other combinations, as well as a growing interest in railroads and municipal monopolies, caused a marked increase of writings dealing with this subject. An incomplete bibliographical summary shows that fifteen treatises or reports of official investiga-

[1] From the *Quarterly Journal of Economics*, Vol. XV, 1901, pp. 167–216.

[2] By "trusts" the writer means those great combinations of capital in our manufacturing industries which are commonly called by this name. It is not the purpose of this paper to deal with the literature devoted primarily to the problems presented by the so-called natural monopolies.

tions and over thirty-five noticeable articles in the chief periodicals appeared between 1887 and 1890. For the next six years the output diminished, probably for the reason that the tariff and the money questions were uppermost in the public mind;[1] and only eight books or reports and hardly more than a score of articles were published during the period. In 1897 and 1898 at least six books or pamphlets and about thirty articles appeared, foreshadowing an increased interest in the problem of monopoly. And, finally, the last two years have given us not less than twenty-eight books, reports, and pamphlets, together with a flood of periodical articles that will reach probably one hundred and fifty titles when the returns for 1900 have all been received. While these figures can claim only substantial accuracy, they will suffice to show that the production of trust literature has kept pace with the process of industrial consolidation.

Any bibliography of these writings, like lists of recently formed trusts, becomes antiquated before it leaves the press, so rapid is the rate of increase. The only serious attempt in this direction is Mr. A. P. C. Griffin's List of Books relating to Trusts,[2] which appeared early last summer. This is of considerable value to the student, but professes to give "only the chief authorities." The list of books and pamphlets is nearly complete, but the reader is surprised to notice that the bibliography refers to Nicholson's short chapter on monopoly value, and does not include the valuable discussion of combinations of capital, contained in Hadley's Economics; while in the references to periodical literature he will often wonder what principles of selection could have been followed.

[1] That the small amount of trust literature that appeared between 1890 and 1896 was due to the predominance of other issues may be inferred from the fact that in 1892 and 1896, the two years when presidential elections occurred, our bibliography shows that no books, and only a few articles, appeared. During the period from 1886 to 1900 these (1892 and 1896) were the only years in which no books were published.

[2] A List of Books (with References to Periodicals) relating to Trusts. Washington, 1900. [A second edition with additions appeared in 1902. The *Quarterly Journal of Economics* also contains in its current bibliography a complete list with annotations of both books and periodical literature on this subject. — ED.] The one other recent list of trust writings that deserves mention may be found in the *Chautauquan*, XXX, 237, 238. For an excellent bibliography of earlier works, see von Halle, Trusts, 338–350 (New York, 1895).

Since the present article must be confined to *recent* literature, it has seemed best to draw a line somewhat arbitrarily at the year 1897, and to exclude from consideration most of the writings that appeared before that date. Within these limits the author will aim to give detailed references to the books, reports and pamphlets that have come to his attention up to the time of writing. In some cases, however, it will be necessary to refer to works that appeared earlier than 1897. With periodical literature no extended bibliography is necessary in these days, when Poole's Index is available for every reader, so that the citations here given will be confined to the most valuable articles, and to some others that are significant as representing certain shades of opinion.

Passing over certain discussions of the monopoly problem that have appeared in some recent economic treatises and general works of reference,[1] which, by the way, may be recommended to those who are beginning the study of this subject, we may divide recent trust literature into eight classes. It is true that any such procedure will be open to the charge of arbitrariness at some points; but, on the other hand, it will avoid so much repetition and bring opposing theories into such clear relief that it may be trusted to commend itself to the reader.

(1) The first of our eight classes comprises the reports of official investigations[2] and the proceedings of conferences called

[1] W. P. D. Bliss, Encyclopædia of Social Reform, 888–894, 1346–1348 (New York, 1898); R. H. I. Palgrave, Dictionary of Political Economy, II, 802–807 (London, 1896); C. J. Bullock, Introduction to the Study of Economics, 309–335 (2d edition, New York and Boston, 1900); A. T. Hadley, Economics, 151–173 (New York, 1896).

[2] Report and Proceedings of the Joint Committee of the Senate and Assembly appointed to investigate Trusts, Senate Document 60 (Albany and New York, 1897); Industrial Commission, Preliminary Report on Trusts (Washington, 1900); Same, Trusts and Industrial Combinations, — Statutes, Decisions and Digest of Corporation Laws; Bulletin of the Department of Labor, No. 29, pp. 661–831, Trusts and Industrial Combinations (Washington, 1900).

The entire report of the United States Industrial Commission has since appeared. Vols. I and XIII are specifically devoted to testimony; Vol. II contains a digest of statutes and decisions; Vol. XVIII is devoted to industrial combinations in Europe; Vol. XIX, pp. 594–685, contains the final report of the commission, with an appended opinion by counsel as to legislation. The Appendix to Vol. XIX, pp. 1120–1128, gives statistics supplementing those in

under the auspices of various organizations.[1] The New York investigation of 1897 was mainly a shrewd political move, intended to prove the undying hostility of the Republican party to trusts; but it brought out some interesting information. The trust magnates summoned to testify before the legislative committee suffered from those attacks of loss of memory with which they are usually afflicted upon such occasions; but Mr. Theodore Havemeyer volunteered the statement that he would not care to engage in a business enterprise that did not promise a profit of 15 or 20 per cent. The Industrial Commission was more successful than any previous body of investigators in securing testimony from persons interested in trusts, and its Report contains a careful digest of evidence that adds greatly to its usefulness. The Standard Oil combination seems to have made a most careful and systematic endeavor to clear itself from the many damaging charges that have been brought against its methods;[2] and, if the public still remains unconvinced of the spotless purity of this organization, it will not be due to any lack of sweeping denial and stout asseveration in the testimony of the oil magnates. The most valuable feature of this Report is the investigation, conducted under the direction of Professor Jenks, into the effect of combinations upon prices. This gives us the best available data for a trustworthy conclusion upon a most fundamental question. Nearly as much can be said of the Digest of Corporation Laws contained in the second volume of the Commission's Report. The conclusions and recommendations

Vol. XIII. On the general work of the commission, cf. *Quarterly Journal of Economics*, XVI, pp. 564–586.

The Twelfth United States Census, Manufactures, Part I, pp. lxxv–lxxxi, specially reports statistics, which are supplemented by Pubs. Amer. Statistical Association, N. S., No. 53, for March, 1901, pp. 1–20. — ED.

[1] The Chicago Conference on Trusts (Chicago, 1900); Official Report of the National Anti-Trust Conference (Chicago, 1900); Corporations and Public Welfare, Addresses at the Annual Meeting of the American Academy of Political and Social Science (New York, 1900).

[2] This testimony of the oil magnates has been gathered together into a single volume, An Inside View of Trusts (New York, 1899), which has been distributed broadcast, probably for "educational purposes."

A carefully edited and annotated edition of this testimony has recently been issued by the *Oil City Derrick*. — ED

advanced by the Commission will never be charged with radicalism, and are marked by extreme sensitiveness concerning the relation of trusts to the protective tariff. The Bulletin of the Department of Labor contains further data concerning the effect of trusts upon prices, and publishes the results of an independent investigation into the working of these combinations. This investigation was conducted by sending out schedules of questions to forty-one organizations; and the Bulletin presents the results in tabular form, whenever that is possible. The information thus gathered is of no little interest; but it must be accepted with certain reservations, since it was not to be expected that the companies answering the inquiries would give testimony adverse to their own interests. This would probably be conceded readily by Professor Jenks, who had charge of the investigation.

The proceedings of the Trust Conference, held under the auspices of the Civic Federation of Chicago, attracted such general attention [1] at the time that little space need be devoted to them in this review. It will suffice to say that, while only a few of the papers and addresses at the conference possess any considerable value in themselves, the proceedings as a whole should be read by every student who desires to form an estimate of the present condition of popular opinion upon trusts. All sorts and conditions of men were present at the conference, and their opinions may be taken as fairly representative of the classes for which they spoke. The Report of the National Anti-Trust Conference has a similar interest, as an expression of the sentiments of a very large class of persons who see little or nothing that is good in the process of industrial consolidation. Some of the addresses contained in the volume are of decided value in calling attention to the undoubted abuses and dangers that attend the movement. Corporations and Public Welfare is devoted largely to discussions of railroads and other public service companies, but contains articles upon industrial securities as investments and the influence of corporations upon political life.

[1] See *Harper's Weekly*, XLIII, 954, 975; *Outlook*, LXIII, 199; *Independent*, LI, 2602; *Review of Reviews*, XX, 457; *Journal of Political Economy*, VIII, 1; *Annals of the American Academy*, XV, 69.

(2) In our second class may be placed those writings in which the trust movement is accepted as inevitable, and its causes, advantages, dangers and proper regulation are discussed. No less than five recent books belong to this group.[1] Harper's Restraint of Trade is a mere collection of extracts from various works upon trusts; but the compiler's opinion is, evidently enough, that "modern industrial conditions have demanded" that the "principle of combination be generally accepted." The books of Baker, Collier, von Halle, and Jenks agree in finding the cause of trusts in the conditions of modern competition and the economies that arise from the combination of capital. These writers hold that the trusts represent a distinct economic gain in productive power, but recognize that these organizations have been attended with many abuses. Professor Jenks and Mr. Collier advocate no radical action to restrain the evils of trusts, but propose various moderate remedies, of which the chief is always publicity. Mr. Baker, however, believes that no efficient method of regulation can be found short of placing a representative of the government upon the board of directors of every combination. The main contention of these works — that trusts are a natural and inevitable outcome of modern conditions — we shall reserve for more extended discussion, in subsequent pages.[2]

A decided majority of the articles that have appeared recently in the periodicals, popular or scientific, should be included in this class.[3] President Hadley and Professor Kinley argue that

[1] C. W. Baker, Monopolies and the People (2d edition, New York and London, 1899); W. M. Collier, The Trusts (New York, 1900); E. L. von Halle, Trusts, or Industrial Combinations in the United States (New York, 1895); W. H. Harper, Restraint of Trade (Chicago, 1900); J. W. Jenks, The Trust Problem (New York, 1900).

[2] With these books should be mentioned the chapter on trusts contained in Professor Giddings's Democracy and Empire, 137–143 (New York, 1900). The author holds that the trust "could never have become the great factor in the commercial world that it is to-day" unless it had been "an efficient device for dealing with existing industrial conditions."

[3] See articles by Hadley, in *Scribner's Magazine*, XXVI, 604; Kinley, in *Progress*, V, 7; Sherwood, in *Yale Review*, VIII, 362; Coleman, in *Journal of Political Economy*, VIII, 19; Robinson, in *Conservative Review*, IV, 33; Jenks, in *Quarterly Journal of Economics*, XV, 46; Smith, in *Chautauquan*, XXIX, 347; Ashley, Surveys,

trusts are due to destructive competition and the superior economy of concentrated production; Professor Sherwood believes that these organizations are the agency through which the most skilful management is secured; Mr. Coleman and Mr. Robinson look upon such combinations as an inevitable product of industrial evolution; and Professor Jenks again presents the views advanced in The Trust Problem. In these articles the reader will find little that is new.

(3) Radically different views are advanced in works of a third class.[1] M. de Rousiers is too faithful to the tenets of the orthodox French school to abandon his belief in the efficacy of the competitive system. His interesting work contains the results of an investigation into the leading industries that have fallen into the hands of trusts. He finds almost everywhere a tendency towards production on a large scale, but thinks that this is not the cause of monopoly. The real cause, he contends, is control over limited supplies of raw material and facilities for transportation, or the special advantages conferred by tariff and patent laws. His remedy for the evils caused by trusts is to abolish all restrictions, and thus to leave competition free to do its perfect work. Professor Ely's recent book is a treatise on the subject of monopoly; and begins with a study of definitions, a classification of monopolies and a formulation of the law of monopoly price. It then proceeds to discuss the subjects of industrial consolidation, the limits of monopoly and the permanence of competition. While the author holds that competition is impossible in the field of the "natural monopolies," he believes that elsewhere the tendency towards consolidation is limited by virtue of the fact that, beyond a certain point, combination of capital is not economical. Our present trusts he believes to be

Historic and Economic, 378–391 (London, 1900). See also article by Carnegie in *Century Magazine*, LX, 145.

[1] P. de Rousiers, Les industries monopolisées aux États-Unis (Paris, 1898); R. T. Ely, Monopolies and Trusts (New York and London, 1900); A. B. Nettleton, Trusts or Competition (Chicago, 1900); H. Wallace, Trusts, and how to deal with them (Des Moines, 1899).

Other secondary treatises, based mainly on American experience, are Le Rossignol, Monopolies Past and Present, 1901; and St. Léon, Cartells et Trusts, Paris, 1903; besides a number of German treatises. — ED.

the result of special privileges and corporate abuses, — a conclusion which is very much like that reached by M. de Rousiers. Mr. Nettleton's book is to a great extent a compilation of facts and opinions, but in the second chapter the author presents his own conclusions in a vigorous argument against the trust. He believes that the economies of consolidation cease before the point of monopoly is reached, and that existing combinations are the "result of monopoly hunger" and the product of railroad discriminations and other unfair privileges. For a remedy he advocates rigorous legal prohibitions, supplemented by a reform of existing abuses. Mr. Henry Wallace concedes that the disorders sometimes attending modern competition not unnaturally lead producers to take refuge in combination. He believes, however, that the trust is a vicious method of remedying the evils which competition sometimes produces, and that the consolidations of recent years have caused a speculative "boom" which is sure to be followed by a disastrous reaction.

To Professor J. B. Clark we owe a series of papers[1] in which the contention is made that, while large scale production is economical and giant industrial undertakings are to be the order of the day, competition is certain to continue, nevertheless. Professor Clark believes that monopoly is almost wholly bad, and that the most efficient management is found in independent establishments, not in monopolistic concerns that are removed from the stimulus of competition. His remedy for evils that attend the present trust movement is to take away from the combinations their favorite weapons, — price discriminations, factors' agreements and other questionable devices, — so that competition can operate without let or hindrance. With this accomplished, he believes that industrial consolidation can proceed to any extent that may be deemed advantageous, without producing the evil results inseparably connected with monopoly.

If a digression is permissible at this point, we may suggest that Ely's Monopolies and Trusts and Jenks's Trust Problem

[1] See Theory of Economic Progress in *Economic Studies*, I, 5 (New York, 1896); *Atlantic Monthly*, LXXXV, 47; *Political Science Quarterly*, XV, 181; *Gunton's Magazine*, XIX, 209. [Moie recently in his Cooper Union lectures.—ED.]

are the works that will be found most useful for the general reader.[1] Both of these books are thoroughly readable, and they will be found to supplement each other in a most helpful manner. Ely discusses the definition and classification of monopolies; while Jenks explains the methods by which trusts are promoted, financed and floated. The one writer formulates the law of monopoly price; and the other furnishes statistics showing precisely what influence combinations have exerted upon prices. The first book presents the arguments of those who believe that the monopolistic features of trusts are due to special privileges and unlawful practices; the second contends that these industrial combinations have developed naturally out of the conditions of modern competition. Monopolies and Trusts advocates remedies that are designed to restore competition to its former position as the fundamental economic force; The Trust Problem accepts the principle of combination, and proposes conservative methods of regulating monopolistic enterprises. From the study of the two books the reader can gain a competent knowledge of the chief subjects that now interest students of this important question.

(4) In a fourth group we may place a number of articles which relate to various phases of the trust movement. Upon the financial aspects of consolidation three references may be commended to the reader.[2] Mr. Charles S. Fairchild has discussed, from the point of view of the practical banker, the financing of trusts. Mr. James B. Dill has called attention to the dangers that have attended the manufacture of industrial securities, often falsely so-called, and has insisted that the only safety for the trusts can be found in the complete abandonment

[1] A new edition of Jenks with additions appeared in 1902. E. S. Meade, Trust Finance, is by far the most comprehensive and convenient treatise in the special field indicated by its title. G. H. Montague, Trusts of To-day, 1904, is a readable and convenient manual of the general subject. Moody, Truth about the Trusts, 1904, is a convenient compilation of data from his annual Manual of Corporations. — ED.

[2] See Fairchild and Dill, in Publications of the American Economic Association, Third Series, I, 149 and 177; Dill, in Corporations and Public Welfare, 107; Dill, The College Man and the Corporate Proposition, privately printed (New York, 1900); and Meade, in *Annals of the American Academy of Political Science*, XVI, 345. [More completely in his Trust Finance. — ED.]

of speculative management; while Dr. E. S. Meade has written a most valuable survey of the financial aspects of the trust problem.

Comparatively little work has been done in recent years upon the history of individual trusts, probably because the consolidation movement has been so well-nigh universal as to draw attention away from the fortunes of particular enterprises. Yet special articles have been devoted to the wire nail association of 1895, the tin-plate combination and some others;[1] while the testimony taken by the Industrial Commission contains a large amount of material for the history of recent industrial changes. Finally, the phenomenal activity of trust promoters in 1898 and the earlier part of 1899 has been well described by Mr. Byron Holt.[2]

(5) A fifth class comprises those writings which relate primarily to the special favors and other abuses by which, undoubtedly, trusts have profited to a considerable extent. Most prominent among such evils has been discrimination in railway rates. Mr. Lloyd's Wealth against Commonwealth did good service in showing the potency of the "smokeless rebate" as a weapon for destroying competition, and few recent writers have failed to say something on this subject.[3] Of late the tendency has been to give too little weight to this factor in the trust problem; and it is well for us to be reminded by Mr. Aldace

[1] See Edgerton, in *Political Science Quarterly*, XII, 246; McVey, in *Yale Review*, VIII, 156; also *Harper's Weekly*, XLII, 202; *Independent*, XLIX, 273. [The United States Steel Corporation is described by H. L. Wilgus, 1901, and fully by Meade in his Trust Finance. Cf. also The Inside History of the Carnegie Steel Co., by J. H Bridge. The *Century Magazine*, in 1902–03, devoted a number of articles to the more prominent combinations. — ED.]

[2] *Review of Reviews*, XIX, 675.

[3] For writings dealing *primarily* with railroad discriminations, see H. D. Lloyd, Wealth against Commonwealth (New York, 1894); J. Hardesty, The Mother of Trusts, 185–208 (Kansas City, 1899); Prouty, in *Annals*, XV, 41; Walker, in *Forum*, XXVII, 256–257; Newcomb, in *Gunton's Magazine*, XVII, 347.

Miss Ida M. Tarbell's History of the Standard Oil Co., which appeared serially in 1902–04 in *McClure's Magazine*, and is about to appear in book form, is by far the most authoritative study which has been made. G. H. Montague's Rise and Progress of the Standard Oil Co., 1903, reprinted from the *Quarterly Journal of Economics*, is rather more favorable to the company

F. Walker that "the trusts have the railroads by the throat," and to have Mr. Prouty, of the Interstate Commerce Commission, explain the precise methods by which the federal law against discriminations is constantly violated.

Naturally enough, the relations of trusts to the protective tariff have claimed the attention of many writers; but comparatively little work has been devoted primarily to this subject. Economists have been so much occupied with discussions of the advantages of large-scale production and the destructive character of competition that they have probably minimized unduly the importance of the tariff as a factor in the present situation. The Industrial Commission, in particular, has evinced such an anxiety that no harm to the cause of high protection shall come from its investigations as to lead the Philadelphia *Ledger* to remark, in a recent editorial, that, "if this be a sample of the character of the inquiry the Industrial Commission is pursuing, it might as well suspend its hearings, since it is plainly committed to the preservation of the trust-promoting and sustaining provisions of the existing tariff, no matter how glaring may be the abuses perpetrated under cover of its schedules." We hardly need to be informed that some trusts are independent of tariff protection, and that combinations of capital exist in England under free trade; since very few people imagine that protective duties are the sole cause of trusts, and we know that unrestricted foreign competition prevents most English combinations from abusing their powers. The chief questions worth discussing are whether, as Mr. Havemeyer alleges, the tariff causes over-investment in certain industries, thus producing a period of depression that results in consolidation; and to what extent the prices of tin-plate, steel rails, wire nails, window glass, paper, salt, sugar, and other articles controlled by trusts or pools, have been raised to exorbitant figures under the shelter of protective duties. In this direction the New England Free Trade League has rendered us a service by publishing a series of letters relating to the extortion practised by many of the trusts.[1]

[1] Twenty-four Letters relating to Trusts and the Tariff (Boston, 649 Tremont Building). See, also, Taussig, in *Quarterly Journal of Economics*, XIV, 500, 501, 503, 507. [Cf. Liefmann, Schutzzoll und Kartelle, Jena, 1903. — Ed.]

(6) In the sixth class belong the writings of the panegyrists of the trust movement.[1] In these works, industrial combinations are represented as the greatest invention and benefaction of this age or almost any other; and those who hold opposing views are designated by such pleasing terms as socialists, demagogues, blackmailers and the like. Popular discontent against trusts is due to "hatred of wealth," hostility to capital or at least to the desire to stir up class feeling and organize a crusade against prosperity. Particular mention will be made only of Gunton's Trusts and the Public, which is an amorphous collection of papers written at various times during the last dozen years. The author is most outspoken in condemning anti-trust agitation, and loud in his praises of industrial combinations, especially the Standard Oil Company. A noticeable feature of the book is the effort made to refute all charges brought against this organization. In the earlier papers, written before 1899, the sugar combination figures as a second model trust; but upon this subject Mr. Gunton's views changed after Mr. Havemeyer went to Washington, and told the Industrial Commission that the tariff is "the mother of all trusts." Before that time Mr. Gunton had insisted that good trusts, like the sugar and oil combinations, formed for economic purposes, are not monopolies; but, after Mr. Havemeyer's fall from grace, we find this author denouncing him as "a cunning monopolist." In a paper written in 1888, which forms the first chapter of the book, Mr. Gunton had proved that fears of the political influence of trusts are unfounded; but in 1899 he wrote that the activity of the sugar magnates in Washington had become "a national scandal," as bad, in fact, as anything that had ever "occurred in

[1] Although works of this class have been distributed broadcast, the writer has not been able to secure copies of all of them. Those at hand are: H. Apthorp, Trusts and their Relation to Industrial Progress (Cleveland, 1899); C. R. Flint, Industrial Combinations (N. P., N. D.); G. Gunton, Trusts and the Public (New York, 1899); D. F. Kennedy, Trusts: An Argument from Labor's Standpoint (N. P., N. D.) Mr. S. C T. Dodd has brought together a number of papers previously published and they now appear under the title Trusts (New York, 1900). As representative of magazine articles of this class, see R. P. Flower, in *Gunton's Magazine*, XIII, 251; Gunton, in *Gunton's Magazine*, XIX, 344. [Cf. The Trust: Its Book. By C. R. Flint, J. J. Hill, S. C. T. Dodd and F. B. Thurber. New York, 1902. — ED.]

the public affairs of the Republic." Mr. Gunton's own conclusion is that, "Tariffs and trusts should be discussed on their own merits, separately,"—a method that certainly possesses the merit of convenience for those who entertain views similar to his own.

(7) Writings of the seventh class we will designate as radical, since they come from those who advocate most radical methods of reform.[1] Mr. Hugh Lusk devotes special attention to the legislation adopted in New Zealand to check the growth of monopoly. Most of the other works included in this group have much to say concerning the relation of the money question to the trust problem. Thus it is urged that the era of falling prices drove producers into consolidation;[2] and "Coin" holds that the "money trust" is the mother of all others, and will ultimately control all other combinations. Of more interest are the specific references to the consolidation now in progress in the world of banking.[3] Beyond all doubt a combination, represented by such institutions as the National City Bank, is now under way, the purpose of which is to dominate the banking business in our chief financial centres. The day may come when all economists will be obliged to give this movement their serious attention.

(8) Our eighth class includes literature on the legal aspects of trusts, of which naturally enough the output has not been small.[4]

[1] F. A. Adams, Who Rules America? (New York, 1899); H. L. Chaffee, Book of Trusts (Chicago, 1900); W. H. Harvey, Coin on Money, Trusts and Imperialism (Chicago, 1899); H. Lusk, Our Foes at Home (New York, 1899); G. H. Shibley, A Trust of Trusts (Chicago, 1898); The Monopoly Question (New York, 1900); Momentous Issues (Chicago, 1900).

[2] See also E. B. Andrews, in *International Journal of Ethics*, IV, 323, and Swain, in Chicago Conference on Trusts, 537–539.

[3] See facts presented in Report of the Anti-Trust Conference, 326–327; Shibley, Momentous Issues, 77–78; Harper, Restraint of Trade, 342–345.

[4] For books see C. F. Beach, Treatise on the Law of Monopolies and Industrial Trusts (St. Louis, 1898); F. H. Cooke, The Law of Trade and Labor Combinations (Chicago, 1898). For important periodical literature see *American Law Register*, XXX, 751; *American Law Review*, XXXIII, 63, 499, XXXIV, 186; *Harvard Law Review*, VII, 128, 157, 333; *American Journal of Sociology*, I, 411; *Political Science Quarterly*, XII, 212, 622; *Quarterly Journal of Economics*, XIV, 416; *Forum*, XXVI, 452, XXVIII, 732.

The best collection of edited cases will be found in Cases on Restraint of

It is not the purpose of this article to emphasize the legal side of the trust question, and a bare outline of the results of recent discussions will suffice. The advocates of trusts believe that the legal position of these corporations is now unassailable. It is conceded that old-fashioned "conspiracies to engross the necessaries of life" are unlawful, and that the early trust agreements or such contracts as that of the Addyston Pipe combination cannot be sustained. But the large corporations now known as trusts are deemed perfectly secure, since the powers of Congress to regulate interstate commerce do not, under the decision of the Supreme Court in the Knight case,[1] extend to manufacturing enterprises; while the states cannot prevent their citizens from selling their property to domestic corporations or restrain them from purchasing the products of foreign companies. Upon the other hand there are those who contend that the formation of a monopoly is illegal, whether this is done by means of a pool, a trust or an incorporated company;[2] and there are not wanting writers who declare that, although state corporations engaged in manufactures are not directly amenable to the power of Congress to control interstate commerce, nevertheless these companies can be reached indirectly by laws excluding the products of monopolistic combinations from interstate commerce, prohibiting such organizations from using the mails, and employing other drastic measures.[3]

Trade, by Professor Bruce Wyman of the Harvard Law School. See also Noyes on Intercorporate Relations and Dill on Corporations, both of 1902, the latter especially on New Jersey practice. F. E. Horack, Organization and Control of Industrial Corporations, Philadelphia, 1903, compiles the law as to publicity. — Ed.

[1] 156 U. S., 1.

[2] Thus it is pointed out that in the Knight case the court had no difficulty in recognizing that the sugar combination was a monopoly, although it declined to interfere on the ground that the manufacture of refined sugar was not interstate commerce.

[3] Besides these eight classes of writings, there remain three pamphlets, for which a single note will suffice. Two of these are by socialists: J. B. Smiley, To What are Trusts Leading? (Chicago, 1899); B. Bouroff, The Impending Crisis (Chicago, 1900). The third describes a farmers' trust, L. L. Hopkins, The Coming Trust (New York, 1900).

II

Of the many important questions involved in the study of trusts, the most fundamental concerns the alleged monopolistic character of these combinations; and, since diagnosis must precede the rational treatment of the disease, — if disease there be, — this aspect of the problem may be considered to possess the greatest theoretical and practical importance. What, then, do recent discussions have to say upon this subject?

From a number of writers we meet the contention that the trusts are not monopolies in any proper sense of the term.[1] Mr. Gunton argues that, whenever these combinations have secured control of their respective industries, this power has come from their ability to render cheaper and better service, and not from the possession of any exclusive privileges. So that potential competition always remains, and monopoly cannot be said to exist. Mr. Dodd says that, since "all are free to combine," competition is not destroyed, but is merely "moved to a higher plane." Mr. Robinson tells us that, while trusts may involve "the repression of competition," they are monopolies neither "in scope nor method"; and many similar citations might be given if space would permit. But some of those who entertain this view of the case have adopted a very different tone when discussing such unfortunate enterprises as the New York Ice combination, which, for some singular reason, was not considered an orthodox trust in good and regular standing.

Some legal writers are inclined to insist upon a narrow definition of monopoly, which would restrict it to those cases where a person or company enjoys an exclusive grant from the government.[2] Thus Mr. Knox declares: "Monopolies can only exist by grant from the sovereign. They cannot be created by contract between individuals." Mr. Dodd would define monop-

[1] For the references, in order, see Gunton, Trusts and the Public, 5, 7, 8, 36; *Gunton's Magazine*, XIX, 350, 351; Dodd, Trusts, 44; Robinson, in *Conservative Review*, IV, 50, 52. See also Chicago Conference, 476; Apthorp, Trusts, 11; *Journal of Political Economy*, VIII, 29; *Forum*, XXVII, 260.

[2] See *American Law Register*, XXXVI, 423; Dodd, Trusts, 36, 37; Chicago Conference, 86.

oly as "a grant by the government for the sole buying, working, making or using of anything"; and Mr. Weil adopts a similar definition. In further support of this view, a few decisions of our courts may be cited.[1] But the general trend of the decisions is overwhelmingly in the contrary direction;[2] and Mr. F. H. Cooke makes a correct statement of the present legal doctrine when he says,[3] "Within a comparatively recent period the conception of a monopoly has been extended from a right created by government to a condition produced by the acts of mere individuals; thus, where within a given area all sales of a given article are made by a single individual or set of individuals."[4]

The vast majority of writers recognize that the trusts generally attempt to secure a monopoly and actually possess monopolistic features, — a fact upon which it is unnecessary to dwell. But oftentimes the word "monopoly" is qualified by the use of such adjectives as "partial," "incomplete," "precarious" or "temporary."[5] It is clear, furthermore, that the meaning attached to the term[6] is such a degree of control over the supply of a commodity as enables the person or persons possessing it to control the price, and fix charges at something more than the normal competitive rate. In order to be complete, the monopoly must be able to maintain prices at the point of highest net returns.

[1] 52 Fed. Rep., 115, 567.

[2] 54 Hun, 354, 356, 376, 379; 30 N. E. R., 279, 290; 44 Fed. Rep., 721; 85 Fed. Rep, 271; 156 U. S., 16, 18; 166 U. S., 322; 175 U. S, 244. The following words of Chief Justice Fuller seem to settle the question: "Again, all the authorities agree that in order to vitiate a contract or combination it is not essential that its result should be a complete monopoly. It is sufficient if it really tends to that end and to deprive the public of the advantages which flow from free competition." 156 U. S., 16.

[3] Law of Trade and Labor Combinations, 94, 95.

[4] For other legal writers holding the same view, see Huffcut, in Industrial Commission, I, part 2, p. 1211; Gaither and Keasbey, in Chicago Conference, 286, 384, and *Harvard Law Review*, XIII, 199.

[5] Jenks, Trust Problem, 61; Sherwood, in *Yale Review*, VIII, 365; Collier, The Trusts, 302; Brooks, in Chicago Conference, 62; Forrest, in *American Journal of Sociology*, V, 241. On the other hand, Andrews says the trusts mean "absolute monopoly" of a permanent character. *International Journal of Ethics*, IV, 325, 326.

[6] *E.g.* see Ely, Monopolies and Trusts, 14; Jenks, Trust Problem, 64, 65.

The conclusion that the element of monopoly inheres in the trust movement is based, in the first place, upon evidence concerning the purposes for which combinations are formed. Prominent business men who have declined invitations to enter trusts, or have had knowledge of the circumstances attending the formation of such enterprises, state most explicitly that the main inducement held out to the owners of the plants which are to be combined is the prospect of controlling the market and exacting higher prices.[1] Then the prospectuses issued by many combinations tell the same story, and control over the greater part of the output must generally be secured before the promoter can make his proposition attractive to financiers and investors.[2] Such control must be obtained at all hazards, even at the expense of paying extortionate prices for efficient plants or buying worthless factories at substantial valuations.[3] Moreover, the tactics employed to stifle possible competition are decidedly unlovely, and are almost inexplicable upon any other assumption than that a desire exists to secure monopolistic powers.[4] Finally, several trust magnates have admitted that the purpose of their companies was to control output and prices, and have conceded that this had been accomplished.[5]

But the best evidence of the existence of such intent is the fact, which appealed so strongly to Judge Taft in the Addyston case,[6] that monopolistic powers have been exercised. Econo-

[1] See T B. Walker, in Chicago Conference, 540, 541; J. S. Pillsbury, in Nettleton, 250, 251; Griffiths, in Report Industrial Commission, I, 176.

[2] See *Annals*, XVI, 358; *Commercial and Financial Chronicle*, July 23, 1898; Nettleton, Trusts, 52.

[3] Thus one concern held up the American Tobacco Company for $12,500,000 in cash. *Annals*, XVI, 364. See, further, Collier, 67, 68; von Halle, 61; Nettleton, 250; Carnegie, in *Century*, LX, 148.

[4] Passing over the more objectionable tactics, a single instance may be cited. The American Tin-Plate Company made contracts with manufacturers of machinery by which the combination was to purchase the entire output. *Yale Review*, VIII, 167; Industrial Commission, I, 179. Could evidence of monopolistic purpose be clearer?

[5] McNulta, Havemeyer and Gates. Industrial Commission, I, 60, 63, 81, part 2, 1009, 1010. Jenks says that in private conversation such persons will usually admit that the chief purpose "has been to check competition." *Quarterly Journal of Economics*, XV, 47.

[6] 175 U. S. R., 237.

mists do not need to be told that a combination that produces from 70 to 90 per cent of the supply can substantially control prices,[1] and this is admitted by such expert witnesses as Messrs. Havemeyer and Archbold.[2] It is well known that many trusts control from 65 to 95 per cent of the products of their respective industries,[3] and that some of them announce from day to day the prices that prevail in domestic markets.[4] Therefore, we are not surprised to learn that the most reliable investigation into prices[5] shows that, in almost every case, combinations have managed to increase the margin[6] between the cost of materials and the price of the finished product for considerable periods of time.[7] This fact establishes the existence of monopolistic intent and monopolistic power.

III

Since most writers recognize that the recent combinations of capital have developed monopolistic tendencies to a considerable extent, the outlook for the future becomes a most interesting and important problem. Under all the circumstances, it is not surprising that recent years have witnessed numerous attempts to bring the control of various industries into the hands of single corporations of colossal magnitude, which possess and exercise the power of monopoly. But the reader of recent trust literature finds that many writers of recognized authority contend

[1] Only Gunton denies this. See *Gunton's Magazine*, XVIII, 566.

[2] Industrial Commission, I, 60, 129.

[3] See Industrial Commissions, I, 18, 19; Bulletin of Department of Labor, No. 29, pp. 731, 735.

[4] Industrial Commission, I, 19; Bulletin, 708.

[5] Industrial Commission, I, 39–57; Bulletin, 708–765; Jenks, 130–170.

[6] On this method of procedure see Bulletin, 709, 710.

[7] Partisans of the trusts follow generally one of two methods when presenting statistics of prices. Sometimes they naively quote merely the prices of refined oil from 1872 to the present, and claim for the trust the credit of the reduction. See Dodd, Trusts, 25, 26, 56; Flower, in *Gunton's Magazine*, XIII, 254; Gunton, Trusts and the Public, 218. In other cases, they exhibit tables showing the margin between the prices of crude and refined oil from 1871 down to the time of writing, and claim for the trust the credit of the decline. Here they carefully avoid comparing the margin before the formation of the trust in 1882 with the margin since that date. See Dodd, 62, 93, 94; Gunton, 14. Comment upon any of these performances is needless.

that these conditions of centralized control are to be permanent in industries that require heavy investments of capital for their successful prosecution, and that competition is a thing of the past.

In considering this proposition, careful discrimination is necessary at the very outset. There are three possible conditions under which industries may be conducted, — production upon a small scale, production upon a large scale and centralized management by a single company or combination. Every student of economic history knows that production upon a small scale was long ago superseded in most important branches of manufactures by undertakings of a large size. The combinations of recent years have sought to replace these large establishments by single consolidated enterprises; and this is the real meaning of the trust movement and the arguments advanced to prove its natural and desirable character. No one wishes to revert to the stage when production was carried on by small establishments. Controversy exists only concerning the advantages of superseding large-scale production by combinations that include all important establishments in a single line of business. The "industrial combination," which those who take a generally favorable view of trusts are upholding, must mean the replacement of independent enterprises already conducted on a large scale by a single centralizad management. To combinations of this character writers may or may not apply the term "monopolies"; but the real issue, nevertheless, is the alleged superiority of a single body of producers over independent rival concerns. When it is contended that combination means not "necessarily one great trust, comprising one great industry," but merely "an enlargement of capital,"[1] we must insist that this is not what the arguments in favor of centralization are considered or designed to prove. When another writer tells us that combination may be contrasted not with competition, but with "isolation," — by which, probably, production in small establishments is to be understood, — we may properly remind him that in his own works combination is used as the opposite of competition, and that he says that sometimes "indus-

[1] Apthorp, Trusts, 25.

trial units which are necessary for proper utilization of labor become so large as to produce actual monopoly."[1] When others tell us that the trusts have seldom secured that immunity from competition which monopoly implies,[2] it must be replied that this fact serves merely to discredit some of the arguments intended to prove the superiority of consolidation, and does not alter the purpose for which these arguments are advanced. If the tendency towards combination means anything, it means the substitution of centralized and consolidated management for the rivalry of independent concerns; and this may fairly be termed monopoly. If, furthermore, the advocates of combinations intend to defend nothing more than production upon a large scale, they should revise their list of arguments designed to prove that competition is "wasteful," "destructive," "suicidal," and "a thing of the past"; and should make it clear that they do not uphold the action of most of our trusts in consolidating all establishments of a given class, in order to "regulate production" or to "remove the evils of competition." We may advise the reader, therefore, to grasp firmly the distinction between large-scale production and monopoly, and to note carefully whether the arguments advanced in favor of combination relate to the one thing or the other. Unless this is done, clearness of thought becomes impossible.

Does the trust movement, then, mean a permanent régime of monopoly in industries where large amounts of capital must be employed? Some writers who consider the movement to be, upon the whole, a desirable development in industry, answer clearly in the negative. Thus Professor Sherwood says[3] that the dominant position which trusts now enjoy depends mainly upon "monopoly of undertaking ability," and that this is "in its nature temporary and the result of a competitive process." The large gains that now accrue to these monopolistic enter-

[1] See Hadley, in *Atlantic Monthly*, LXXIX, 377, 378. With this compare Hadley's Economics, 153, 154. The passage quoted refers immediately to public service industries, but at the bottom of page 154 the author applies this and other arguments to other branches of business

[2] Collier, 106; von Halle, 72; *Gunton's Magazine*, XIX, 350: Apthorp, 11.

[3] *Yale Review*, VIII, 365–368.

prises are merely a temporary reward for the development of a superior form of business organization. And Mr. Carnegie, Mr. Dill, Mr. Wanamaker, and others[1] insist that "every attempt to monopolize the manufacture of any staple article carries within its own bosom the seeds of failure," or that "no men, or body of men, have ever been able, or will be able, permanently to hold control of any one article of trade and commerce."

But the arguments of most of those who take a favorable view of trusts cannot be given such interpretation. Some writers state clearly and frankly[2] that "the competitive system of industry is fast passing away," and that all lines of business "are, or soon are to be, monopolized"; that "monopolies of every sort are an inevitable result from certain conditions of modern civilization"; "that experience seems to justify the belief that monopoly within certain limits . . . may be secured simply by the possession of large capital"; or that trusts represent "a vast accumulation of productive resources which renders the competition of small concerns hopeless." And this is the view, of course, which is entertained by persons of socialistic tendencies.[3] Sometimes it is attempted to add force to such arguments by calling combination the result of an evolutionary process of survival; and one writer remarks[4] that the trust is "an evolution from the *heterogeneous* to the *homogeneous*,"—a statement which will interest those who happen to remember the Spencerian formula.

But other economists are less explicit. Writing of the trusts, von Halle says[5] that "in the manufacturing industries, the victory of production on a large scale seems assured"; and he

[1] *Century Magazine*, LX, 148; Dill, The Corporate Proposition, 18; Corporations and Public Welfare, 128; Chicago Conference, 576, 623

[2] See, in order, Andrews, in *International Journal of Ethics*, IV, 321, 333; Baker, 159; Jenks, 64, 65; *American Journal of Sociology*, V, 232. With these see Kinley, in Progress, V, 18; Shaw, in Nettleton, 36, 41.

[3] See writer quoted by Ely, Monopolies, 146; J. A. Hobson, Evolution of Modern Capitalism, 126 (London, 1894). [4] *Century Magazine*, LX, 144.

[5] Trusts, 63, 140, 149. For another failure to make clear the distinction between large-scale production and monopoly, and therefore a failure to convey a clear impression to the reader, see Holt, in *Review of Reviews*, XIX, 675.

concludes his work with the somewhat oracular remark that "the future belongs neither to the prophets of individualism, nor to the ideals of the social democrats." Mr. Brooks thinks that "practical monopolies" have been formed, but that they can be permanent only in case "they put some kind of economic superiority upon the market."[1] Mr. Collier, rather inconsistently, says that competition is "business committing suicide," and then thinks that the trusts will be controlled by potential competition.[2] Professor Bemis looks upon a trust as "virtually a monopoly of large capital," possessing "vast possibilities of social advantage"; but thinks that we cannot pronounce a final judgment "until we have first removed all special privileges."[3] And, finally, President Hadley believes that modern conditions "work in favor of those who advocate combination, and make it harder for independent competitors to resist it, or for the law to prohibit it on grounds of public policy"; yet he holds that, if prices are raised unduly, "new capital will come into the business."[4] But, if the advantages of industrial combinations, in both producing and marketing their products, are as great as most of these writers affirm, it is hard to see how unity of management can fail to secure ultimate control of most branches of manufactures. The lack of explicit forecasts of the future need not, therefore, prevent us from concluding that the general position of these economists is that a tendency to permanent monopoly may be clearly recognized.

But economists who think that, for the future, monopoly is to be the order of the day, generally consider that this control of industry will be limited by what is termed potential competition. Thus they do not affirm that absolute monopoly will prevail, but merely such a control of production and prices as will not tempt new capital into the field. To this subject we shall return in our later paragraphs.

Attention may now be directed to the reasons for this belief

[1] Chicago Conference, 62. [2] The Trusts, 53, 143, 106.

[3] Chicago Conference, 395, 399; Report of Anti-Trust Conference, 339, 342.

[4] Economics, 153, 161. In *Scribner's Magazine*, XXVI, 607, he is more explicit,—sufficiently so, perhaps, to justify our classing him with the writers mentioned in the previous paragraph.

in the tendency of large-scale production to pass over into monopoly, and to the criticism which such views evoke from writers who deny the existence of such a tendency. In favor of this proposition three general lines of arguments may be distinguished: (*a*) the contention that a consolidated enterprise possesses advantages over independent companies in producing and marketing its goods; (*b*) the claim that mere mass of capital confers powers of destructive warfare so great as to deter possible competitors from entering the field; (*c*) the belief that modern competition between large rival establishments, representing heavy investments of fixed capital, is injurious to the public, ruinous to the producers and in its final outcome self-destructive. As our discussion proceeds, it will become evident to the reader that all of these arguments can be employed, with consistency, only by those who believe that the competitive régime is to be replaced by an era of monopoly.

IV

First in this list is the contention that a consolidated concern is a more efficient agent of production and exchange. It is claimed that a combination can effect a saving in no less than twenty different directions;[1] and the economy arising from such sources is declared to be great enough to give the trust a control over the market based solely upon superior efficiency,[2] and to make competition "hopeless."[3] For this reason it is held that such combinations may confer "enormous" benefits upon society.[4] The critic may well entertain the suspicion, however, after reading what is said upon this subject, that these arguments prove almost too much; for, if in twenty directions substantial economies may be realized by a combination, it would seem that the utter futility of competition would have been recognized by the business world long ago. If these argu-

[1] For detailed lists of these economies see Baker, 9–14; Jenks, 21–43, 212–213; Gunton, 11, 12, 37, 38; Ely, 145–160; Collier, 61–77; *Quarterly Journal of Economics*, XV, 49; *Progress*, V, 23–25; Nettleton, 19, 20, 25–27

[2] See Gunton, Trusts, 5, 36; *Gunton's Magazine*, XIX, 350, 351; Chicago Conference, 476, 477, 588. [3] *American Journal of Sociology*, V. 232.

[4] Jenks, 213. See also Baker, 25; Collier, 37–39; *Progress*, V, 18.

ments be altogether true, how is it that the trusts find competition so troublesome, and consider it "good business" to resort to the most disagreeable means of driving "interlopers" out of the field? Such tactics are decidedly "bad business," if they are needless; and we can hardly think that the shrewd managers of the trusts would care to arouse public resentment by unnecessarily harsh methods.

To consider this line of argument in any complete manner would expand this article into a volume; and we can discuss, therefore, only some of the more important savings that trusts are believed to realize. Of the twenty specific economies that have been enumerated, we shall take no notice of five which may be considered either doubtful or of minor importance.[1] Six others will be relegated to a foot-note, since it may be denied emphatically that they represent any substantial advantages which large independent companies cannot secure.[2] Three more

[1] These alleged advantages are: (1) combinations will prevent adulteration and improve products; (2) they will reduce losses from unwise extension of credits; (3) they will not suffer from stoppage of work by accidents in any one locality, or by labor troubles; (4) they need to carry smaller stocks of goods to meet demands of the market; (5) they may eliminate needless middlemen.

[2] These six items illustrate the necessity of discriminating sharply between large-scale production and monopoly. (1) It is said that combinations can specialize the machinery of the separate plants, thus saving the loss resulting from changing from one kind of work to another. Jenks, 36, 37. But large independent concerns have often done the same thing. (2) Combinations can push trade in foreign markets. But large independent companies have been equally successful, or almost so. This claim provokes a smile from a Minneapolis miller. See Nettleton, 250. Such concerns as the Baldwin Locomotive Company deny that combination is necessary for this purpose. Rivals of the Standard Oil Company are now following the trust into European markets. Industrial Commission, I, 22. The Industrial Commission concluded that foreign trade does not need a monopoly. *Op. cit.*, 23. Wherever a combination, by keeping domestic prices at high figures, is able to sell a larger surplus abroad at low rates, we may deny the desirability of such extension of trade. On the general subject see Nettleton, 65–66. (3) Trusts can conduct auxiliary or subsidiary industries. So do many independent enterprises. Note Taussig's description of the extent of the activities of our large iron and steel companies. *Quarterly Journal of Economics*, XIV, 159, 160. (4) Trusts utilize by-products. So do large independent establishments, while small establishments sometimes coöperate for this purpose. (5) Trusts can employ chemists, inventors and other experts to improve methods. This has for years been done by many large companies not in combinations. (6) Trusts can insure their own plants. But independent concerns may coöperate in establishing factory insurance companies, and secure the lowest possible rates, as some of our textile trades have done.

may be set aside for incidental discussion[1] in connection with the views of those who deny the tendency to monopoly. Of the remainder, three items relate to advantages in the manufacture and three to economies in the exchange of products.

Thus it is claimed that trusts, by filling orders from the nearest plant, can effect a great saving in cross-freights. Data upon this question are available in the recent Bulletin of the Department of Labor.[2] Of the forty-one combinations reporting, twenty-seven failed to answer this question, nine claimed a saving from this source, and five stated that there was no gain. Of the nine reporting a saving, the Bulletin states the amount only in three cases; and in two of these the item of cross-freights was combined with other economies, the aggregate sums being $400,000 and "considerably over $500,000." This, be it remembered, is the trusts' own showing, and is certainly not an underestimate. The reason for these comparatively small results is not difficult to discover, and has been recently explained by a writer who has heretofore emphasized most strongly this particular economy of consolidation.[3] When the monopolized product is of a bulky sort, the industry is already localized pretty thoroughly before combination takes place; and, since most of the former independent establishments were producing chiefly for their natural local constituencies, the trust can save little in cross-freights. When, however, the product is light, transportation charges become a matter of small moment. In either case the room for saving in cross-freights is not nearly as large as has been represented, while often it does not exist.

Then it is urged that a trust can draw upon all the patented devices of the constituent companies, and employ only those that are most efficient. But advantages accruing from this fact will in most cases prove to be of a temporary nature, as trusts that have tried to base a monopoly upon the control of all available patents have learned in the past, and will learn in the future. Moreover, a simple reform in our patent laws will make

[1] These three advantages are (1) combinations can specialize skill in management; (2) they can compare methods and costs of production in different plants; (3) fixed charges decrease as the size of the enterprise increases.

[2] Bulletin, No. 29, p. 673. [3] Jenks, in *Quarterly Journal of Economics*, XV, 49.

the best processes available for all producers [1] at any time that the public finds such a measure to be necessary for protection against monopoly. Here, then, we find no natural law working resistlessly towards combination, but a man-made device which can be regulated as public policy may dictate.

Again, we are told that a trust can produce more cheaply than separate concerns, because all the plants utilized can be run at their full capacity; whereas, under competition, many establishments can be kept in operation but a part of the time. Two observations may be made concerning this claim. First, the extent of the economies thus realized is grossly exaggerated. The whiskey combination furnishes the stock illustration employed to enforce this argument; [2] and we are told that this trust was able to close all but twelve out of the eighty constituent plants, and yet produce almost the same quantity of spirits that formerly had been put upon the market. But the distilling industry is a highly exceptional case. For twenty-five years prior to the formation of the trust the federal tax upon whiskey had been so manipulated by the distillers as to call into the industry enormously excessive investments of capital. Competition, of itself, would never have produced conditions even remotely resembling those that prevailed in this business from 1865 to 1887. [3] The sugar refining industry is another stock illustration, but here, it is conceded, [4] the tariff had given an undue stimulus to investments; and the same thing is true, probably, of many, if not most, of the trusts that have been able to close up a considerable number of plants. [5] In general,

[1] All writers recognize that patents have contributed materially to the establishment of certain monopolies. See the case of the American Steel and Wire Company. Industrial Commission, I, 18. Some measure of reform in our patent laws is favored by such a conservative writer as J. B. Clark and by some of those who uphold trusts. See Chicago Conference, 408; Jenks, 220, 221; Collier, 201.

[2] See Jenks, Trust Problem, 34; von Halle, Trusts, 59, 66.

[3] These facts are clearly stated by Jenks in *Political Science Quarterly*, IV, 297 *et seq.*

[4] Jenks, Trust Problem, 45. See Havemeyer's testimony, in Industrial Commission, I, 59.

[5] For other cases see *Yale Review*, VII, 315, VIII, 157, 170; Industrial Commission, I, 207. Other instances can be found without great difficulty.

it may be denied that, whenever governmental interference has not produced unhealthy and abnormal conditions, competition has led to such absurdly excessive investments as is commonly assumed. We must concede, however, that under normal conditions some reduction can be made in the number of plants required to supply the market at ordinary times; but this does not dispose of the matter. If a trust is to be prepared for supplying the market promptly in times of rapidly increasing demand, it is necessary that some surplus productive capacity must exist in periods of stationary or decreasing demand; for, as believers in the tendency to monopoly often remind us, many months, or even one or two years, are required for the construction of new plants. When this fact is taken into account, the case will stand as follows: except where the action of government has produced abnormal conditions, the capacity of competing establishments does not exceed the requirements of the market to any such degree as is commonly assumed; even a trust must provide for periods of expanding trade, and this fact diminishes materially the margin for saving by avoiding the burden of idle factories; even then, not all rival establishments suffer seriously from inability to find continuous employment for their plants, so that probably the advantages secured by the trust are of consequence only when the least fortunate or least efficient independent concerns are made the basis of comparison. In those cases, however, where abnormal conditions have been created by the operation of our tax laws, we need entertain no surprise at the appearance of consolidated companies. But in the future, it may be asserted, this particular force will not prevent rival companies from competing for a share of an increasing trade.

The last three economies relate to advantages in buying materials or selling products. It is urged that a combination can purchase its raw materials more cheaply than separate concerns. This would probably be interesting news to many large companies not connected with trusts, and Professor Ely is undoubtedly right in remarking that all ability in bargaining is not controlled by combinations[1] No one doubts that a large

[1] Monopolies, 162, 163.

company can often secure better terms than a small establishment; but it is not so clear that every trust can secure supplies more cheaply than large independent enterprises, unless it is true that all combinations can arbitrarily depress the prices of the materials which they consume. Undoubtedly, this has been done by some of the trusts,[1] although their partisans deny it;[2] but such a saving represents no social gain, and sometimes it may be possible for would-be competitors to profit by the depressed condition of the market for raw materials. We do not need to deny that *any* combination can gain an advantage in the purchase of supplies,[3] in order to support the contention that no *general* advantage accrues to the trusts from this source. On this point the Bulletin of the Department of Labor shows that a majority of the forty-one combinations investigated "did not answer this question specifically," while the representations made by the minority claimed no great economy in purchases except in a few cases. Even when considerable savings are realized, it is always possible that these represent, chiefly or wholly, gains on that part of the aggregate purchases which was formerly made by the smaller and weaker establishments; so that the realizing of a net gain does not establish the existence of an advantage over the largest companies that entered the combination.

And, finally, we come to economies in advertising and in soliciting business, where the wastes of competition are certainly serious and the room for improvement correspondingly great. Those who deny the tendency to monopoly generally admit that a trust can have a material advantage here,[4] while those who affirm the existence of such a tendency evidently realize that their case is strongest at this point.[5] Yet an opportunity for saving in these departments does not always exist,[6] and the extent

[1] Industrial Commission, I, 17, 142; Jenks, 155, 156; von Halle, 70.

[2] See Gunton, 82–87; Dodd, 62, 76. Dodd claims that the oil combination has *raised* the price of crude oil.

[3] For an instance, see Jenks, 145, 146.

[4] Ely, 167; Nettleton, 64.

[5] Jenks, 67, 68; Collier, 37, 61. Both of these writers admit that the gains of combination are rather in marketing products than the work of manufacture.

[6] Bulletin of Department of Labor, No. 29, p. 673 Here it is stated that several trusts reported that there was no saving in advertising, while one combination reported that more was spent.

of the economy is easily exaggerated in other cases. Mr. Nettleton is right when he says:[1] "But to whatever extent the trust-organizers have counted on practically cancelling expenditure for these two items, on the ground that buyers will be obliged to come to the sole manufacturers, they are likely to be surprised. Those trusts that have tried this experiment have discovered that demand for commodities falls off with remarkable rapidity as soon as effort in pushing sales is materially reduced. To an extent which few appreciate, the buying public has become accustomed to being reminded of its needs before making purchases. The country merchant often has more inertia than enterprise, and, with the periodical visits of his favorite drummer discontinued, his orders dwindle or are delayed until unseasonable. Except in staple and absolutely necessary commodities, demand is largely created and maintained by advertising through periodicals, catalogues or travelling salesman. Hence, the trust that expects to save the bulk of this important item must also expect to lose through diminished sales more than the economy represents. This is not theory, but the testimony of leading dealers in many lines." Moreover, those who believe in the permanence of competition will not lose sight of another consideration which is advanced by Professor Marshall,[2] who writes concerning the economies accruing from these sources: "But its weakness in this regard lies in the fact that to keep its monopoly it must be always bargaining and manœuvring on a large scale. And if its monopoly is invaded, it must bargain and manœuvre widely in matters of detail as well as in larger affairs."

The result of our discussion up to this point would seem to be that any advantages of a monopoly over independent concerns of a large size are but slight, except in the single matter of effecting sales. We must now take into account certain counteracting forces, upon which some writers rest their belief that competition will ultimately prevail. These economists contend, in the first place, that, outside the field of the natural monopolies, the growth of a business enterprise is limited by the fact that companies of a certain size will secure "maximum

[1] Trusts, 64. [2] Marshall, Some Aspects of Competition, 24.

efficiency" of investment, and that beyond this point concentration brings no increase in productive capacity. Without introducing the arguments of professional economists upon the subject,[1] it may be pointed out that this view is entertained by many men who have a practical acquaintance with our large manufacturing industries.[2] This position is based upon the belief that a factory of a certain size will enable machinery to be employed in the most advantageous manner; that a reasonable number of such plants will make possible all needful specialization of production; that allied and subsidiary industries can be, and are, carried on by large independent concerns; and that the cost and difficulties of supervision increase rapidly after a business is enlarged beyond a certain size, especially when it is attempted to unite plants situated in different parts of the country. For this reason, increased output does not decrease the burden of fixed charges after a company attains a certain magnitude;[3] but, on the contrary, new charges arise. Among such new expenses, not the least important are the cost of employing the most skilled legal talent to steer the combination just close enough to the law, the expenses necessary for "legislative" and "educational" purposes, and the outlays for stifling competition or the continual "buying out" of would-be rivals.

Not only is it denied that consolidation secures no decrease of fixed charges over independent concerns possessing sufficient capital, but it is argued that an established monopoly will suffer actual loss from listless and unprogressive management. As the *New York Journal of Commerce* rightly insists, "it is not to be denied that such concentrations of management will be subject to countervailing offsets from the absence of the stimulus of competition; from the uncertainty about the management

[1] See Clark, in Chicago Conference, 405; Adams, *op. cit*, 37; Ely, 165, 166; Rousiers, 281, 320; Meade, in *Annals*, XVI, 353. See also Chicago Conference, 620; Nettleton, 62, 63. Even Jenks wavers at this point, 68.

[2] See Studebaker, in Chicago Conference, 575; Mr. Converse, of Baldwin Locomotive Works, in *Springfield Republican*, Dec. 20, 1900; Messrs. Doscher, Post, Clarke, Griffiths and Taylor, in Industrial Commission, 68, 88, 185; Pillsbury, in Nettleton, 251.

[3] An alleged decrease is one of the twenty supposed economies of combination.

falling into the best possible hands; from the discouragement to invention which always attends monopoly; and from the possibility that the administration may be intrusted to 'friends' rather than to experts." And the existence of such drawbacks is admitted by many of those who believe combination to be desirable and inevitable.[1] As Professor Clark suggests, an established monopoly, secure in the possession of the markets of a large country, "would not need to be forever pulling out its machines and putting in better," so that, as compared with countries where industry is upon a competitive basis, such a combination would fall behind in the struggle for international trade.[2] In ruthlessly and unceasingly displacing the expensive machinery with newer and better appliances, American manufacturers have probably led the world; but monopolies will inevitably feel reluctant to continue such an energetic policy of improvement. As combinations obtain a greater age, they will persist in old and established methods;[3] while nepotism and favoritism, tending towards hereditary office-holding,[4] will replace the energetic management that some of the trusts now display. Andrews is correct in holding that the quest for able and progressive management, which often marks the efforts of existing trusts to make their dominating position secure, is no argument against the probability of future apathy when monopolies have been long established.[5]

Here we may refer to two of the alleged advantages of trusts. It is said that combinations develop abler management through the opportunity they afford for a specialization of skill upon the part of their officials,[6] and that efficiency is increased by a

[1] See Andrews, in *International Journal of Ethics*, IV, 327, 328; Hadley, 159; Collier, 124 Sherwood thinks a point may be reached where monopoly "tends to prevent improvement" *Yale Review*, VIII, 367. Gunton and von Halle admit that, if complete control of markets could be secured, this would be the result *Gunton's Magazine*, XIX, 349; Trusts, 68. See references to Jenks and Hadley in subsequent notes.

[2] *Gunton's Magazine*, XIX, 210. Cf. *Political Science Quarterly*, XV, 184.

[3] See Ely, 167. Note Hadley, in *Atlantic Monthly*, LXXIX, 383.

[4] See admission of Jenks, in *Quarterly Journal of Economics*, XV, 51–53.

[5] *International Journal of Ethics*, IV, 327, 328.

[6] Jenks, Trust Problem, 36, 37; *Quarterly Journal of Economics*, XV, 51.

comparison of the methods and costs of production in the various plants.[1] The first of these advantages may be open to question, since it is not clear that large independent concerns do not afford sufficient room for specialization of talent; while it may be denied that, in the long run, any possible gain from this source will suffice to counterbalance the apathy begotten by monopoly. Concerning the second it may be remarked that, at the outset, this gain would accrue only to the least efficient plants, and would not make the combination superior to the best of the original establishments; while, after a time, although all the factories might be brought up to the same level, the lack of competition would retard the rate of future improvement.

When it is contended that the "strength of the trust is that it gives the opportunity for the exercise of these highest qualities of industrial leadership," and that it gives us "a process of natural selection of the very highest order,"[2] we may question whether stock speculation and other causes lying outside the sphere of mere productive efficiency have not had more to do with the formation of recent combinations than demonstrated superiority in business management. And, even if it be admitted that dominating powers of leadership have played their part in the movement, it may be asserted that the establishment of permanent monopoly[3] will interfere seriously with the future process of selection. Professor Lindsay has remarked very justly[4] that the "development of a high order of undertaking genius in the few seems . . . to depend upon a wide range of undertaking experience in the many," and that under a régime of trusts "we would in the course of a few generations have very little available material from which to make selections." It must be remembered that the able leaders now at the head of the successful trusts were developed out of a field which afforded the widest opportunity for creative ability and independent

[1] Bulletin of Department of Labor, No. 29, p. 675; Collier, 77.

[2] Sherwood, in *Yale Review*, VIII, 364.

[3] I am not unmindful of the fact that Professor Sherwood considers such monopoly to be in its very nature temporary. This part of the argument relates to the claims of many writers that monopoly is to be permanent

[4] See *Publications of American Economic Association*, Third Series, I, 204.

initiative. These are the supreme qualities requisite for great industrial leadership; and they are not likely to be fostered by a régime which, if the believers in monopoly are to be taken at their word, closes each important branch of manufactures to new enterprise, and renders hopeless all competition with a single consolidated company. Will successive generations of bureau chiefs or heads of departments in long-established corporations be able to continue the race of masterful leaders, which freedom in originating and organizing independent industries has given us in the present age?

This leads to another consideration. In an industry organized upon a national scale, under the control of a single company, there must arise an "irrepressible conflict" between that central responsibility necessary for intelligent, unified management and that individual freedom and energy requisite for the healthful life of the separate members.[1] For centralized control, elaborate and costly administrative apparatus is absolutely essential; and this mechanism of superintendence soon becomes fixed and bureaucratic in its methods, so that it bears heavily upon the individual parts. President Hadley has said recently that, as trusts gain in age and experience, good private business will become so similar to good public business that it will make little difference whether an enterprise is carried on by the public or by individuals.[2] In one respect, at least, his argument is well founded. Governmental enterprises usually suffer, at least when conducted upon an extensive scale, from the lack of that stimulus which only competition can give and from the growth of fixed bureaucratic methods of control. A private monopoly that engrosses an entire branch of industry must develop inevitably, in the course of time, the very characteristics that impair the efficiency of a public undertaking.[3] Both will exhibit the tendency to unprogressive management which comes from the

[1] This has been pointed out by Professor Marshall, Some Aspects of Competition, 17.

[2] *Scribner's Magazine*, XXVI, 610.

[3] President Andrews confronts this question squarely when he says, "In this important regard the system of trusts is obnoxious to the same criticism nearly always made against socialism." *International Journal of Ethics*, IV, 328.

absence of competition[1] and the weight of centralized administrative machinery.

When all the arguments are sifted, and the balance of advantage or disadvantage is determined, there is reason for thinking that the losses due to monopoly will more than offset occasional slight gains in the work of manufacture and the more substantial savings in placing products upon the market. This conclusion is strengthened by the showing which most of the trusts have made in the payment of dividends upon their securities. As is well known, the preferred shares have usually represented the amount paid in cash or securities for the plants that have been purchased and for the working capital supplied by the financier. The common stock represented nothing more than "the substance of things hoped for" in the way of alleged economies of operation. Although times have been unusually prosperous, and prices, already high, have often been increased by the trusts, dividends on the common stock have almost universally disappointed the expectations of those who invested with the hope of securing a part of the "enormous" savings of combination.[2]

V

The second argument advanced to prove the tendency to monopoly is the claim that mere mass of capital confers such powers of destructive warfare as to deter possible competitors from entering the industry, at least until prices have long been held above the competitive rate. It is said that a large combination can lower prices below the cost of production in any

[1] The writer does not overlook the fact that believers in monopoly contend that potential competition survives the formation of trusts. But in subsequent paragraphs it will be shown that, if the arguments advanced to prove the superior efficiency of trusts are sound, competition cannot continue in any form.

[2] Another consideration bearing upon this question of the efficiency of trusts is the fact that they have, in order to obtain control of their industries, bought up large numbers of antiquated or badly situated plants which will be a permanent burden. See Collier, 67, 68; von Halle, 61; Jenks, 195–197; Trust Conference, 623; *Century Magazine*, LX, 148; Nettleton, 250. In cases where plants are paid for by issues of preferred stock, as has usually been the case, the sums paid for worthless properties will affect dividends, but not financial solvency. Where bonds have been issued, however, then the burden will become more serious

locality where a small rival concern is established, thus driving it out of the field. If, on the other hand, a large rival company attempts to compete in all markets, this will mean an investment of capital in excess of the needs of trade, with a consequent depression of business and loss to all concerned.[1] Without doubt the destructive competition waged by combinations is an important consideration, and it may well enough reenforce monopoly where other attendant circumstances favor consolidation.[2] But a monopoly based solely upon this power would be, confessedly, a temporary affair; for probably no one would claim that all capitalists would be intimidated permanently by such circumstances. This argument, therefore, may be used properly enough to strengthen the conclusions drawn from the alleged economies in production; but it does not of itself establish the existence of a permanent tendency to monopoly. Of this truth, any one who observes the trouble which trusts are having with new enterprises at the present moment may obtain sufficient evidence.[3]

It should not be forgotten, furthermore, that this argument depends upon the fact that combinations at present are allowed to employ the weapons of discriminating prices and other tactics, which violate every one's sense of fair play although they may be difficult to suppress. If uniform price lists could be made obligatory, then this power of intimidating rivals would largely disappear; for, if a trust must give its products away in all markets in order to ruin a competitor who enters a portion of the field, then its losses would be proportionate to the mass of capital, and the advantage over the independent concern would disappear.[4] Without doubt the prevention of price discrimina-

[1] Jenks, 66, 67; Forrest, in *American Journal of Sociology*, V, 241; Collier, 129; Baker, 350, 351.

[2] This is admitted by Ely, 178.

[3] One illustration from an earlier period may be cited. At the opening of 1892 it is said that the lead trust owned all the establishments in the country except two. In 1894, however, there were in existence independent plants producing as large a product as the trust. The trust had a capitalization of $30,000,000, the independent companies employed a capital of $2,000,000. See *Popular Science Monthly*, XLIV, 741, 742. More recent illustrations will be presented later.

[4] This is urged by Clark in *Political Science Quarterly*, XV, 194.

tions would be a work of great difficulty; but, if this must be done in order to prevent the abuses of monopoly, then some way of accomplishing the result can and will be found. Such a remedy will be less difficult than the elaborate schemes which those who believe in trusts advocate in order to remove admitted abuses in other directions. The menace of mere mass of capital is at the most a cause of temporary monopoly, and its potency can be destroyed by depriving the trusts of their favorite method of "sand-bagging" competitors.

VI

The final reason for the belief that combinations must ultimately prevail is found in the character of modern competition in those industries which require heavy investments of fixed capital. Under such conditions the difficulty of withdrawing specialized investments and the losses that are entailed by a suspension of production make competition so intense that prices may be forced far below a profitable level without decreasing the output; and industrial depression inevitably follows.[1] For such constant fluctuations in prices, combination is considered the natural and inevitable remedy. Some writers allege, furthermore, that it "is not possible to have competition without competitors, and, if there be competitors, one must prevail," so that monopoly "is the inevitable fruit of competition."[2]

The socialist who reads some of these arguments must feel that at last many of the criticisms which he has long urged against competition have been accepted by economists of the orthodox type. Certainly, few stronger indictments of the competitive régime have been formulated by socialistic critics of the existing social order. Thus the believers in trusts tell us that "individ-

ualism and the competitive system have run their course"; that "the competitive system of industry is fast passing away"; that competition is "inadequate and wasteful," resulting in "general depression" and "industrial loss"; that the competitive régime leads to warfare that is first "intense," then "destructive," then "self-destructive"; that competition is not the "life," but "the death of trade" and "a destroying force to those engaged in it," so that it is termed "business committing suicide."[1] Professor Ely remarks, justly enough, that such contentions are "a virtual surrender to the theory of socialism."[2] In any event, the reader will perceive that it is idle for economists who hold these views to imagine that their theories do not lead to the conclusion that competition is impossible and permanent monopoly inevitable in the industries to which the discussion relates.

In continuation of this line of argument, it is said that trusts are beneficial, because they can "exercise a rational control over industry," and "adjust production to consumption."[3] Thus it is believed that commercial crises can be prevented, or, at least, that their worst effects can be avoided.[4] But such arguments overlook the facts that a restriction placed upon production by a trust, especially if this is sufficient to raise prices above the competitive rate, may react injuriously upon other trades;[5] and that monopoly profits, accruing to a small body of capitalists for a long period of time, must constitute a tax upon the body of the people that will affect the distribution of wealth in such a way as to reduce the consuming power of the masses.[6] A reduction

[1] For these references in order see *Independent*, XLIX, 273; *International Journal of Ethics*, iv, 321; Nettleton, 36; Jenks, 199, 212, 213; Collier, 43; *Progress*, V, 18; Chicago Conference, 288; Collier, 55.

[2] Monopolies, 168.

[3] Gunton, 77, 78, 254, 255; Chicago Conference, 58, 69, 550; Apthorp, 25; Collier, 73; *International Journal of Ethics*, IV, 331; Hadley, in *Scribner's*, XXVI, 606.

[4] I shall pass over without comment such statements as "With a consuming power of 75,000,000, we have a producing power of 150,000,000," and the like. Thurber, in *Arena*, XXII, 310. Cf. Collier, 71.

[5] Note Marshall, Some Aspects of Competition, 24; Adams, in Chicago Conference, 37; also Bemis, *op. cit.*, 398.

[6] Even if trusts do not reduce nominal rates of wages, — as we are told they will not, — such a tax would result from holding prices above the competitive rate; for this would diminish real wages and decrease purchasing power.

in purchasing power thus produced would render excessive the existing investments in staple industries, and produce crises in precisely the manner described by Rodbertus and Marx. It will probably be wise, in any case, to postpone a final conclusion upon this subject until we know the ultimate consequences of the present depression in Germany, — a country whose industries are to a large extent "regulated" by various combinations. And it remains to be seen how our own trusts will deal with the almost inevitable reaction from the intense speculative activity of recent years in the United States. If trusts are unable to destroy the competition that is now disturbing the serenity of their managers, and must meet with continual interference from "interlopers," it may turn out that combinations professing ability to secure large profits on excessive capitalization are such a tempting mark for rival capital that our new remedy for industrial depression will merely intensify the evils which it was designed to cure.

Not only is it doubtful whether monopoly is a wise method of regulating industry, but it is certain that the evils of competition are greatly exaggerated in some cases,[1] while in others they are due to unhealthful conditions for which an interference with industrial freedom is responsible. Mention has already been made of the distilling industry, which has served as a typical example of the evils of competition and the benefits of combination. Here all will admit that excessive investment was due to the unwise action of Congress in changing the rate of taxation in such a manner as to benefit the distillers, and to lax enforcement of the revenue laws, which enabled those who evaded the exciseman to realize a profit of several hundred per cent. In this case, depression was not due to mere competition; and,

[1] While business depression is commonly assigned as the cause of combination (see Industrial Commission, I, 214, part 2, 21, 109, 168, 169, 255, 811), especially by trust magnates, it is certain that the large majority of our present trusts were formed in a period of unusual prosperity, when the stock market offered an opportunity for large speculative gains. Even when depression is known to have been a cause of consolidation, sometimes not all the companies, but only the weaker ones, were losing money. See *Yale Review*, VIII, 157; *Annals*, XVI, 355; Industrial Commission, I, 176. It is notorious that it has been the weaker plants that were most anxious for combination, while the better concerns could be induced to join, in many cases, only by the offer of excessive prices for their factories. Note Collier, 208, 209.

moreover, the formation of pools, and finally a trust, served merely to call more capital into the industry and to intensify the evils.[1]

In many other industries where trusts have been formed, the excessive investment of which writers complain was caused by the undue stimulus given by high protective duties and by the restriction of foreign competition. Upon over-investments caused by increases in the tariff, enough has been said in a previous paragraph; but the second topic requires further explanation. The iron and steel industries are the best illustration of the periodic fluctuations of prices, of which the believers in trusts complain; and Professor Taussig has recently demonstrated that these phenomena are greatly intensified by the operation of our tariff.[2] He shows that in times of rising prices the restriction of importation has thrown upon domestic producers nearly the whole work of supplying the expanding market. Since new plants cannot be erected in a short time, prices increase enormously before domestic production equals the demand. These high prices cause excessive investment, and hasten a reaction which results in a consequent period of depression. During the recent "boom" in the iron markets of the world, English prices rose from $9.80 to $16.70 per ton for one grade of pig iron, and from $11.70 to $18.60 for another, an increase of 70 per cent for the first kind and 59 per cent for the second. At the same time American prices rose from $10.00 to $25.00 per ton, an increase of 150 per cent, so that the absence of foreign competition made the fluctuations more than twice as great as they were in the English market. This, he adds, "is but an illustration of the simple principle that, the wider the range of the sources of supply, the greater the steadiness of prices." When Mr. Carnegie complains,[3] therefore, of the alternating periods of expansion and depression that beset the iron industry, he merely emphasizes the connection between our protective tariff and the intensification of the causes that

[1] This is conceded by Jenks, Trust Problem, 149; *Political Science Quarterly*, IV, 314.

[2] *Quarterly Journal of Economics*, XIV, 479–484.

[3] *Century Magazine*, LX, 147.

are alleged to produce trusts. Since the range of our protected industries is so great, the importance of the considerations just presented can hardly be overestimated. Competition is restricted by protective duties in most of the industries where combinations are formed; these duties increase the severity, and perhaps the frequency, of the fluctuations from which business suffers; then trusts, a further restriction of freedom, are advocated as a remedy for the ills caused by the initial interference with individual enterprise; and, finally, in order to regulate the trusts, an elaborate system of public supervision is proposed. Would it not be well to make a genuine trial of competition before condemning it for producing evils which are greatly increased by governmental interference with industrial freedom?

Competition cannot be proved a failure until it is given a trial. The evils from which many economists would seek refuge in industrial combination are greatly increased by unwise laws which have now outlived any usefulness that originally they may have possessed. If unhealthful conditions produced by our own interference with the course of business are ever removed, competition will probably develop no evils which could not be borne, as vastly preferable to monopoly, public or private. Indeed, even as things are, the shortcomings of the competitive system are exaggerated; and attempted monopoly is more likely in the end to increase, rather than mitigate, those periodic fluctuations from which industry suffers.

VII

Monopoly is not a pleasant word, and believers in the wasteful and destructive character of competition prefer to speak of trusts as combinations; or, when they use the term "monopoly," hasten to explain that this does not imply the absence of all competition. Thus it is said[1] that either actual or potential competition will oblige the trusts to share with the public the savings arising from consolidation, and will protect the consumer

[1] See Hadley, 161–163; Jenks, 224; Apthorp, 11; Gunton, 24, 25, 193–196; *Gunton's Magazine*, XIX, 349–351; *Progress*, V. 59; Industrial Commission, I, 200. This list of citations could be extended almost indefinitely.

from serious injury. Since this argument has been allowed hitherto to pass without serious criticism, the reader is asked to give it a moment's consideration.

When Professor Clark says that the actual investment of new capital is not always necessary in order to restrain the power of a combination to raise prices, because the mere possibility of rivals entering the field may suffice,[1] his argument is not inconsistent or absurd, because he does not believe that a monopoly is a more efficient agent of production than a large independent concern, or that the competitive régime is necessarily destructive and suicidal. And, when he shows that this "potential" competition of new capital can be made more effective by abolishing railroad discriminations and discriminating prices, he makes a distinct contribution to the discussion of the trust problem. But no such argument can come, without manifest inconsistency, from economists who believe that a trust is superior to independent companies. The gulf between permanent monopoly and competition cannot be bridged, even by appealing to such a subtle agency as potential competition.

In the first place, competition, actual or potential, could not distribute among consumers more than the most infinitesimal share of the alleged economies of monopoly. The reader will remember that the advocates of combination consider that it is proved that a single company can produce and market commodities at a much lower cost than independent concerns. If this be true, we may assume that, if the lowest price at which an independent company can afford to sell a commodity be one dollar, a combination can afford to sell for still less, say eighty cents, and that the difference of twenty cents represents the savings effected by monopoly. Now it is evident that competition can never, except for relatively short periods when the market is overstocked, reduce the price below one dollar, and that producers will never enter the field unless they hope to be able to secure at least these figures. A monopoly, therefore, can maintain the price at ninety-nine and nine-tenths cents without inviting competition; and the public cannot hope to secure more than the most insignificant fraction of the savings due to

[1] Chicago Conference, 407–409; *Political Science Quarterly*, XV, 186.

consolidation. Competition, manifestly, can do no more than prevent prices from rising as high as one dollar. Competitors might, at the outset, enter the industry under a misapprehension of the situation; but it would soon be demonstrated that a price just under one dollar would make competition hopeless. If, moreover, as is alleged, mere mass of capital tends to deter competition until prices are raised somewhat above the competitive point,[1] this argument becomes still stronger; and it would seem that the monopoly might charge even one dollar without holding out sufficient inducements to possible rivals. Thus the whole saving, and possibly something more, would go to the combination.

Secondly, even if competition could hold monopolistic power in check, the remedy would be wasteful and uneconomic, and would mark a return to the very evils which combination is supposed to cure. The argument for monopoly is based upon the claim that competition is wasteful, destructive and productive of all the evils in the calendar. To remedy the evils of competition, it is proposed to resort to combination: then, to cure the wrongs of monopoly, it is argued that we can return to competition. Indeed, the evils of renewed competition after monopoly has once been established are more intense, since the chances are that the high profits of the combination will call too much capital into the field; so that the last state of the industry that has been regulated "rationally" and "scientifically" by a single company will be worse than the first. Moreover, if combination possesses all the advantages that are claimed for it, wise public policy would necessitate the adoption of some method of preventing waste from the useless duplication of manufacturing plants. In public service industries, where all people have become convinced that competition does result disastrously both to producer and consumer, such a restrictive policy has been followed. We no longer think of paralleling existing lines of railroad in order to remedy the evils of extortion, and few cities will in the future permit their streets to be torn up in order to install unnecessary gas or water mains. If, in manufacturing business, consolidation has all, or nearly all,

[1] This is argued by Jenks, 65–68; Collier, 126–128.

of the advantages which it possesses in the railway, gas or water industries, public policy will dictate that the evil results of competition be recognized and that future waste of capital in rival establishments be prevented. The arguments in favor of combination suffer from a superabundance of proof that monopoly is more efficient in production and more healthful and rational in seeking for public favor. Those who accept these arguments as correct should carry them to their logical conclusion, and admit that competition is an undesirable remedy for whatever evils monopoly may develop,[1] and that public regulation is the only available method of correction short of socialism.

Finally, it should be remarked that competition is not only an undesirable, but an impossible remedy, if the tendency to monopoly is as strong as represented. If competition with consolidated concerns is hopeless on account of advantages in producing and marketing goods, capital will soon find this out, and refrain from further meddling with enterprises that are foredoomed to failure. If the business world becomes convinced that competition inevitably leads to suicidal warfare when large investments of capital are involved, then public opinion or positive restraints of law will demand that further criminal waste of capital and energy shall cease. *Potential* competition will lose all of its virtue when the futility and folly of *actual* competition are once forced upon the convictions of those who possess capital; and, when this happens, the monopolist will soon forget that the danger of rivalry ever existed. If experience ever demonstrates that the arguments of many economists are correct, then we shall be confronted by the grim fact that competition is dead and that monopoly is inevitable in most important branches of manufacturing industry. Remedy there will be none, save public ownership or public regulation; and past experience raises uncomfortable doubts whether, under the second method, the government or the trusts would be the regulating power.

[1] So far as I am aware, Mr. Baker is the only writer who accepts the results of his own logic. Monopolies, 204, 205.

VIII

The reader will have observed that most of the questions raised by this survey of trust literature do not admit of the application of precise methods of determination, and that all that can be done is to weigh opposing forces and form a rough estimate, based upon general impressions oftener than exact measurement, of the relative strength of the advantages and disadvantages of consolidation. While conclusions thus reached fall far short of certainty, and prediction is dangerous, this is due to the fact that data for a more exact investigation are denied to economists, who can, at the best, secure but occasional glimpses into the inner workings of great business corporations or draw what inferences seem warranted by the facts that come to the attention of the public. This examination of the recent drift of opinion concerning trusts would seem to have established only two conclusions: first, it will be wise to maintain a position of scepticism concerning the alleged advantages of combinations; and, secondly, it is very important to notice that the alleged tendency to permanent monopoly is irreconcilable with the continuation of anything that properly can be called competition.

If we adopt the conclusion that it is improbable that trusts are caused by superior efficiency in production, we are not, of course, without assignable reasons adequate to explain the movement towards consolidation in the United States. Control over limited supplies of natural resources is the strength of some combinations; railway discriminations, patent rights, and the shelter of protective duties have given material comfort and support to others. The opportunity to secure fancy prices for manufacturing plants, which could then be capitalized at still higher figures for the profit of the promoter and financier, is another explanation of vast importance. With so many premiums offered for combinations, the only cause for wonder is that any industries have escaped consolidation. Finally, the losses that competition often entails, which have been made worse by unwise laws, have furnished a pretext of no little

plausibility for attempts to form monopolies. It is at this point that the arguments in favor of trusts possess most weight.

Yet, with all the strength that the movement towards combination has acquired, competition has always vexed the would-be monopolist, and is especially active at the present moment. As this is written, one trust is already confronted by fourteen independent companies, while another rival enterprise with a capital of $1,000,000 is in process of formation. Another combination owning 290 mills was, in October, confronted by independent companies operating 74 mills; and in December a new concern with a capital of $5,000,000 was formed. Almost every day brings word of the appearance of new competitors for various trusts, and the *New York Journal of Commerce* says that the revival of competition may be considered a general movement. Some of the independent enterprises may have been started with the purpose of selling out to the trusts; but, if combinations have the superior efficiency that is claimed for them, they are under no obligation to purchase, and the investors in rival concerns would be taking inconceivable risks if competition were really useless. Trusts purchase rival concerns because competition from such companies is dangerous, and not hopeless; and the revival of independent enterprise is a reason for believing that the business world has not accepted the theory that a combination possesses material advantages over separate companies of a large size. Experience may yet demonstrate that the attempt to "regulate" industry by consolidated enterprise is the surest method of producing over-investment and depression.[1]

If one concedes that competition is attended with real evils, he is admitting nothing that economists have not known for a long time; and, if it is denied that combination is a good, or even possible, remedy for the ills from which we occasionally suffer, all hope of escape does not disappear. The growth of fixed capital has undoubtedly introduced into industry a disturbing element, productive sometimes of fluctuating prices and excessive investments of capital in certain directions. The situa-

[1] On the inevitable persistence of competition, even under a general attempt to establish monopolies, see Clark in *Economic Studies*, I, 13.

tion can be improved by the repeal of unwise laws that intensify whatever unhealthful tendencies competition may have; and, beyond that, relief can be found in measures that will raise business management to a higher plane. The moral and legal responsibility of our captains of industry must be made commensurate with the enormous powers that they wield; and the same moral restraints to which, in the last analysis, even believers in combination appeal,[1] would prove a solvent of the very ills which monopoly is supposed to remedy. Then sound judgment can be fostered by the further development of industrial statistics; and, finally, the substitution of a moderate policy in the place of monopoly-hunger would be more helpful than all else. It may be found, in the long run, that a willingness to allow one's neighbors to live not only possesses more solid advantages than the "economies of combination," but is the only basis upon which private ownership and control of industry can continue. As corporate enterprises in America grow older, each company may cease to be dominated by a few men; and the management may come to represent the average opinion of the stockholders.[2] Such conditions would probably favor the development of a "live and let live" policy. In any event, it will prove easier to impress upon independent business firms the saving grace of moderation than to persuade the monopolist to exercise his powers in a wise and benevolent manner. Good despots there have been, undoubtedly; but we have had no experience with human nature that goes to prove that autocratic control is generally safer in industry than in politics.

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[1] See Hadley, 120; Andrews, in *International Journal of Ethics*, IV, 334.

[2] Note Marshall's comparison of English and American corporation methods, Some Aspects of Competition, 14.

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